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FTSE 100 battles lethargy

Blue chip index fails to reward investors

DANIEL COATSWORTH

It is hard to get too excited about the FTSE 100 just now. During my research for this week's cover story on the health of blue chip dividends, it occurred to me that there are only a limited number of stocks in the FTSE 100 in which I would personally invest at present. Some of my colleagues might disagree, which is why you will see plenty of positive stories on FTSE 100 stocks in the magazine. Perhaps I am more cautious than most.

Nearly every stock either operates in an industry with depressed or uncertain market conditions, earnings growth is grinding to a halt or there are never-ending regulatory issues. If I'm going to risk my money, I want superior rewards.

Many investors flock to the FTSE 100 because they assume these companies are too big to fail. Indeed, a six-monthly trip to the dentist the other day resulted in a conversation about the blue chips. My dentist had previously been burnt investing in an AIM miner that went bust, so he now says he will stick to the FTSE 100 because he assumed they are bigger, more robust names. This is a classic mistake which many investors will have made and may now be regretting.

NO RETURN

The FTSE 100 index has actually been a poor performer this year. Investors would have lost money through buying a tracker fund as the total return is a mere 0.0379%, which would have been wiped out by fees.

In comparison, the FTSE 250 index total return year-to-date is a much healthier 9.65%. There is much to like about mid cap stocks. Contract wins, positive trading updates and earnings upgrades are more likely to act as major share price catalysts for FTSE 250 firms than similar events at FTSE 100 stocks. Dividends among mid cap stocks have the potential to grow at a faster rate than blue chip peers. It is arguably easier to understand the full workings of a mid-cap company than the giant corporates who may have hundreds of divisions and operations around the world.

As an index, it is often stated that the FTSE 100 is really governed by natural resource companies. This argument is no longer credible. Oil, gas and miners now only represent 17.3% of the total index, down from 31% three years earlier.

That looks like it could fall even further with **Randgold Resources (RRS)** on the cusp of losing its place in the blue chip index and big problems facing **BHP Billiton (BLT)** in the wake of a tailings dam spill at its 50%-owned Samarco iron ore mine in Brazil. The latter could result in significant environmental clean-up and legal costs, together with lost cash flow, all likely to weigh on the company's share price and market valuation.

Investment bank Jefferies believes the operation – accounting for 3% of BHP's forecast earnings – could be closed for a long time, perhaps years. 'BHP and Vale (the other joint owner of Samarco) are good operators who consider safety to be a top priority. Tailings dams do fail some times, and accidents can happen even for those miners that take safety the most seriously. A disaster of this magnitude, however, is likely to have a long-term negative impact on the reputations of these two companies,' it adds.

LIST OF ISSUES

Looking at the list of FTSE 100 stocks, ranked by market cap from big to small, every sector seems to have issues that warrant investors receiving extra rewards to compensate for the risks of putting money into this area of the market. Here are a few examples.

- Oil, gas and mining stocks: Commodity prices unlikely to stage major rebound soon. Inadequate free cash flow puts question mark over sustainability of most of the relevant FTSE 100 constituent's dividends. The stocks look expensive on a price to earnings (PE) basis.
- Pharmaceuticals: Concerns about potential US market drug price cap takes the shine off the sector. Investor sentiment is poor at present with high probability of profit taking in the sector following a big rally over the past few years.
- Housebuilders: Shares are coming under pressure after a multi-year rally. Analysts believe margins could start to be squeezed if construction costs go up and house prices fall down.
- Banks: Dogged by fines and regulatory pressures for many years, these trends are still intact but banks look like they could be turning a corner. PE ratios look reasonable, so banks are one of the more interesting parts of the FTSE 100 for investors. Nevertheless, it would be nice to have greater dividends from the sector.

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@SharesMag

editorial@sharesmagazine.co.uk

The Editor, Shares, 49 Southwark Bridge Road, London, SE1 9HH

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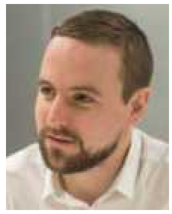

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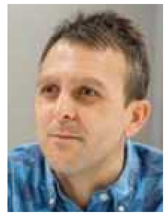

Online Editor:
Steven Frazer
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Companies Editor:
William Cain
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Personal Finance Editor:
Emily Perryman
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Reporter:
James Crux
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Reporter:
Mark Dunne
@SharesMagMark

Reporter:
Seán Flynn
@SharesMagSean

PRODUCTION
Head of Production
Michael Duncan

Designer
Rebecca Bodi

Junior Designer
Ronan Gallocker

ADVERTISING
Advertising Manager
Marcus Reilly
020 7378 4582

Sales Executive
Nick Frankland
020 7378 4592

Managing Director
Mike Boydell

Marketing & Circulation
marketing@sharesmagazine.co.uk

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Travel with Thomas Cook

Share price weakness is a buying opportunity as China deal nears fruition

EMILY PERRYMAN

The market's over–reaction to the impact the cancellation of flights to and from Sharm el-Sheikh will have on **Thomas Cook (TCG)** is a buying opportunity as the company moves forward with its turnaround plan.

Thomas Cook's shares fell by 6.4% to 114.7p last week after the UK cancelled flights to and from the popular Egyptian resort following news the Russian aircraft crash on 31 October was most likely caused by a terrorist attack.

Although it is a blow for the £1.8 billion cap, we think the effect of the flight suspension has been exaggerated. Egypt accounts for around 3% of the group's annual bookings and, of that 3%, Sharm el-Sheikh is thought to represent just a quarter.

Langton Capital analyst Mark Brumby points out that leisure travel is a growth industry which is aspirational and there are other destinations which could see a boost in the winter sun market, such as The Canaries, Florida and possibly Thailand.

Thomas Cook is still getting bad press over the tragic deaths nine years ago of two children from carbon monoxide poisoning at a hotel booked through the company. It was also hit by the terrorist attack in Tunisia in June and has faced significant foreign exchange headwinds. These have caused the share price to drop by 10% so far this year, but we think a revival is on the cards.

The group unveiled a turnaround plan earlier this year which it hopes will put it back into the black. The most notable development is its joint venture with China-based **Fosun International (0656:HK)**, which is expected to become operational by the end of 2015.

The joint venture will develop inbound and outbound tourism activities for the Chinese market and, via an investment fund, buy hotels within the Thomas Cook 'concept' portfolio. The latter will give Thomas Cook more control over supply and price, thus boosting margins.

Fosun has acquired 5% of Thomas Cook and plans to raise its stake to 10% in the future. Brumby suggests Fosun could even take control of the group completely.

Thomas Cook has been through a refinancing this year and raised a bond, which has given it a stronger balance sheet. The company expects to start paying a dividend again in 2016.

SHARES SAYS: ▲▼

It's early days but Thomas Cook looks like a good turnaround story and we believe there is huge potential from the Fosun partnership. Buy.

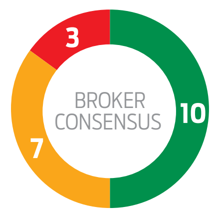
SWOT ANALYSIS

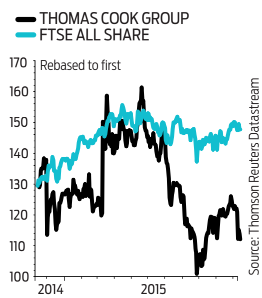
STRENGTHS
- Fosun partnership
- Improving cash generation
- Strong brand

WEAKNESSES
- Structurally challenged industry
- Restructuring costs
- Foreign exchange headwinds

OPPORTUNITIES
- Increased access to concept hotel content
- Reduce net debt
- Pay dividend

THREATS
- Political unrest and terrorism
- Economic downturn
- Competition from online travel agents and low-cost airlines





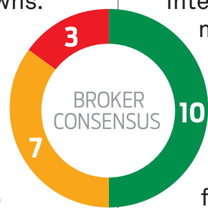
Marks & Spencer's margin beat

Bolland's focus on clothing profitability looks a sensible strategy

JAMES CRUX

BRITAIN'S BIGGEST CLOTHING retailer **Marks & Spencer (MKS)** looks interesting following better-than-expected first half profit. Chief executive Marc Bolland's conscious decision to prioritise clothing margins over sales seems sensible, while a positive Christmas in fashion could enliven the share price.

Interims (4 Nov) revealed a better-than-expected 6.1% rise in pre-tax profit to £284 million. Like-for-like sales in UK General Merchandise (including clothing) fell 1.2% due to a washout August and lesser markdowns. Encouragingly full-year gross margin guidance was revised up, reflecting improved sourcing and stronger full-price sales.



Ongoing market share erosion is a concern, though the improving quality and style of its fashion ranges sets M&S up nicely for Christmas. Evidence of a better General Merchandise like-for-like performance in the third quarter update (7 Jan) could drive a re-rating.

In any event, M&S' differentiated food business provides ballast, having now generated 24 consecutive quarters of like-for-like growth in a difficult UK market.

Furthermore, the high street bellwether is becoming far more shareholder friendly, with improved cash generation underpinning a 6.3% interim dividend hike to 6.8p and a £150 million buyback underway.

Broker Jefferies has a 'buy' rating and 660p price target, suggesting 25% upside scope, while Haitong Securities is also a buyer, seeing fair value of 630p. For the year to March 2016, Haitong forecasts £694 million pre–tax profit (2015: £661 million) for earnings of 36.2p (2015: 32.9p) and an increase in the shareholder reward from 18p to 19.8p.

SHARES SAYS: ▲▼

At 527.5p, a prospective PE ratio of 14.6 is undemanding and a positive festive fashion turn could spark a re-rating.

Square peg in round IPO hole

US mobile payments float could act as investor appetite barometer

STEVEN FRAZER

SOME ANALYSTS ARE growing worried that the soon-to-float mobile payments 'unicorn' Square could disappoint and effectively tighten the screw on the wider global technology IPO pipeline. The company, founded and run by **Twitter (TWTR:NYSE)** founder Jack Dorsey, revealed an indicative pricing range for its forthcoming flotation on the New York Stock Exchange of $11.00 to $13.00 per share, effectively valuing the business as low as $4.2 billion, according to some estimates. That's a massive $1.8 billion below the valuation of its last private equity financing round struck in October 2014.

Those previous investors had their stakes underwritten, which means a final IPO valuation below $6 billion will spark additional shares being issued to balance the valuation books and avoid past private equity investors being diluted. While this would not affect new investors it would send a strongly negative message around the private equity community that public market appetite is waning, potentially closing the taps on many of the private equity to public market opportunities through 2016.

'A poor, or even just unexciting, market debut for Square would be another blow to valuations and private equity confidence,' says Peter Roe, analyst at the respected UK technology website TechMarketViews. Panmure Gordon technology analyst George O'Connor has said, via his Twitter account, that his company is seeing a 'very healthy IPO pipeline and investors are keen.'

SHARES SAYS:

A solid pipeline of IPOs are vital to the long-run health of stock markets, we suggest watching Square for positive or negative indicators.

Rate hike saga

TALK OF A US interest rate hike has been revived after a strong non-farm payrolls number on 6 November.

A 271,000 print for net jobs added is widely considered to have increased the chances of a first increase in the Federal Funds rate for almost a decade.

Commentators including emerging markets fund manager Jan Dehn at **Ashmore (ASHM)** are now tiring of the on-off speculation on US rates and wish the central bank would 'get on with it'.

Dehn argues interest rate hikes are good for emerging markets and the same for developed market equities: typically interest rate increases occur when central banks believe economic activity is improving.

Others argue the US and global economy is too fragile currently to sustain anything but minor increases in borrowing costs.

Ray Dalio, manager of the world's largest hedge fund Bridgewater, said earlier this year there is not much evidence to suggest rates can rise dramatically given the current economic outlook.

Dalio argues the Federal Reserve will need to loosen policy more dramatically before rates can be raised meaningfully.

Pressure on Blinkx

VIDEO SEARCH ENGINE **Blinkx (BLNX:AIM)** could come under more pressure if it fails to reassure investors over progress on its mobile strategy. The £100 million cap has been rationalising its portfolio and investing in new products but investors are showing strong signs that they are losing patience. The shares have fallen nearly 90% in two years to 24.9p. (SFr)

IHG denies sale gossip

HOLIDAY INN OWNER **InterContinental Hotels (IHG)** has denied reports it is considering a sale or merger of the company. The £6.6 billion cap, which has been the subject of frequent bid speculation, saw its shares spike 6.2% to £27.74 following a story by *Bloomberg* on 6 November. It is also rumoured to be buying Fairmont Hotels & Resorts. (EP)

Sportech ends takeover talks

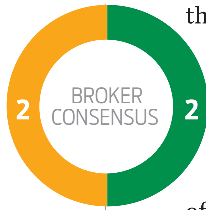
POOL BETTING ORGANISATION **Sportech's (SPO)** share price plunged 10% to 55.3p on 6 November after it said it had ended talks with prospective suitor **Contagious Gaming (CNS:CVE)**. The £113 million cap has received other approaches for its football pools operations (EP)

Dignity's strong delivery

Company boasts earnings and successful growth formula

JAMES CRUX

Sole UK-listed funeral services provider **Dignity (DTY)** looks as attractive as ever after underscoring its investment credentials with an upgrades-stoking third quarter update (9 Nov). *Shares* is sticking with its positive view on this high-quality stock given an increasingly strong competitive position.



The £1.2 billion cap's third quarter results confirmed a strong performance from the funerals, crematoria and pre-arranged funeral plans play, which guided towards a full-year profits beat. Trading year-to-date has been supported by a 9% rise in the number of UK deaths to 446,000, driving sales up 15.6% to £227 million and underlying operating profit 22% higher to £78.1 million.

Mean reversion of the difficult-to-forecast death rate, always a sensitive subject to broach, is likely. Chief Executive Mike McCollum cautiones 'there remains a strong possibility that the number of deaths in 2016 may in turn be significantly lower and therefore the group's expectations for 2016 and beyond remain unchanged.' That said, Dignity has exposure to a demographic tipping point; people may be individually living longer, but collectively, there are more older people, which means the absolute number of deaths will increase long-term.

Shares has long-championed the merits of the Sutton Coldfield-headquartered company; the non-discretionary nature of the business means the company is highly defensive, benefiting from low customer price elasticity and dependable earnings which convert efficiently into cash. McCollum remains focused on the fundamentals of Dignity's business (see *Shares, Griller, 11 Jun '15*) namely maintaining high levels of customer service, keeping costs under control and pursuing acquisitions.

Dignity, whose national coverage means it can make acquisitions anywhere in the country, is successfully consolidating a fragmented industry in which there are opportunities to buy long-established, bigger-than-average funeral businesses. The company completed the acquisition of 36 locations from Laurel Funerals in July and has acquired a further 12 funeral locations for £10.9 million year-to-date, taking total investment in the year to £49.2 million.

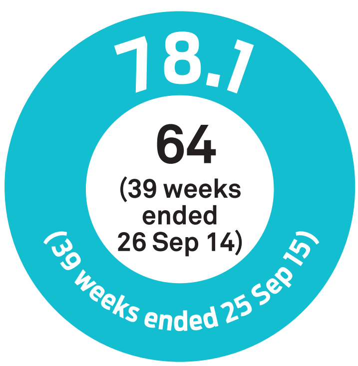
For calendar 2015, Investec Securities' upgraded estimates now suggest 13.8% growth in 'normalised' pre-tax profit to £66.6 million for earnings of 105.9p (2014: 85.8p), ahead of £70.3 million pre-tax profit for 5.8% growth in earnings to 112p for 2016. The broker forecasts a 10.3% dividend hike to 21.5p this year, ahead of a 9.8% rise to 23.6p next year.

SHARES SAYS: ▲▼

At £25.71, Dignity is a core holding for investors seeking growth and income, the latter arising from a progressive dividend as well as scope for further capital returns. (JC)

REVENUE (£ MILLION)

UNDERLYING OPERATING PROFIT (£ MILLION)



NUMBER OF DEATHS

Source: Dignity/RNS

Debt-free dividend picks

N+1 Singer publishes list of well covered dividends

WILLIAM CAIN

Dividend cuts this year have hit income investors hard but there are still a number of attractive shares with decent yields, according to analysts at N+1 Singer.

Markets may be inefficiently pricing some dividend scenarios, the N+1 Singer team argue, providing investors with a way to profit from a 'dividend surprise' rally when results are announced.

A dividend surprise can take many forms, the analysts say in a 9 November 2015 note, including:

• Stocks with high yields sometimes rally when a company announces its payout will be maintained.

• Businesses at the end of large capital expenditure programmes create an opportunity for a step-change in dividend payouts and/or special distributions.

'Amid a background of uneven and subdued economic growth, persistent low interest rates and choppy financial markets, we posit the idea that "dividend surprise" may be a significant contributor to outperformance in the short to medium term,' says the report.

N+1 Singer screened the FTSE All-Share and AIM 100 for dividends which are covered by net cash in the balance sheet and free cash flow. This created 71 stocks with no (net) debt, from which N+1 selected its top 10 picks.

The list shows which of the 71 stocks from N+1's screen had a yield of more than 4%.

'There are always limitations to the effectiveness of a screening process,' the report says.

'Therefore our research team considered the wider fundamentals of the 71 companies that emerged from the screen, for dividend surprise.'

N+1 Singer's preferred picks from the screened stocks include financial companies **Aberdeen Asset Management (ADN)**, **Brewin Dolphin (BRW)**, **Hansard Global (HSD)**, **Jupiter Fund Management (JUP)** and retailer **Safestyle UK (SFE:AIM)**.

Aberdeen also named five stocks with the potential for a 'dividend surprise' that did not appear from its stock screen. These were engineer **Bodycote (BOY)**, chemicals outfits **Elementis (ELM)** and **Victrex (VCT)**, outsourcer **Redde (REDD:AIM)** furniture retailer **ScS (SCS)** and

Engineer Bodycote, for example, failed the screen because it has a small net debt position, but as N+1 analyst Jo Reedman writes 'that is forecast to move to a net cash position this year – and the company paid special dividends in the last two years'.

Redde has a policy of returning all of its earnings to shareholders, which means it would have failed the free cash flow cover screen. Elementis, Victrex and SCS are also special dividend candidates in the future, N+1 argues.

STOCK SCREEN - DIVIDEND POTENTIAL

Ticker	Company	Price (5/11) (p)	Net cash as multiple of '15 divs	FCF dividend cover	Yield (%)
ADN	Aberdeen Asset Man.	350	1.4	2.0	5.5
BEZ	Beazley	367	1.3	3.9	4.5
BRW	Brewin Dolphin	267	3.6	2.0	4.3
CSN	Chesnara	410	7.9	2.5	6.0
FDSA	Fidessa	1986	1.9	4.1	4.3
GMD	GAME Digital	228	4.0	21.8	8.9
GAW	Games Workshop	558	1.2	1.6	6.0
HSD	Hansard Global	158	5.4	1.8	7.7
JUP	Jupiter	450	2.5	2.0	5.3
LGEN	Legal & General	269	20.7	8.1	5.0
SFE	Safecharge	218	1.9	1.5	4.6
SOCO	SOCO International	184	3.1	1.8	6.0

Source: N+1 Singer
Note: Net cash and free cash flow is taken from prior year, not forecast

Rocky road for Stagecoach

Public transport specialist faces challenges on all sides

SEAN FLYNN

DECLINING REVENUE IN **Stagecoach's (SGC)** North American operations, the impact of UK devolution and falling fuel prices are combining to undermine the £2 billion cap's future prospects.

Lower fuel costs continue to impact demand adversely for Stagecoach's Megabus inter-city coach services as people take to their own cars. Like-for-like revenue at Megabus North America in the five months ended 30 September 2015 was 5.9% below the equivalent period last year.

Trading elsewhere in the North America division and its joint venture, Twin America, appears to be broadly in line. Widening start-up losses on the group's European variant of the Megabus franchise are also adding to investors' worries.

As highlighted in our last public transport sector report (see *Sector Report, Shares*, 15 Oct); 'with greater exposure to issues like the living wage and Bus Service Operator's Grant (BSOG) rebates, Stagecoach looks less attractive than its peers in the bus space. Furthermore, maintaining its current high rail exposure may not be achievable (it currently holds a 23.4% market share)'.

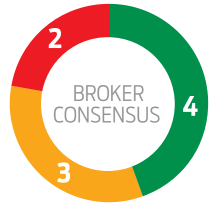
Devolution also has the potential to prompt significant changes to the UK's regional bus market. Current proposals centre around a Quality Contract Scheme (QCS) of regulated buses.

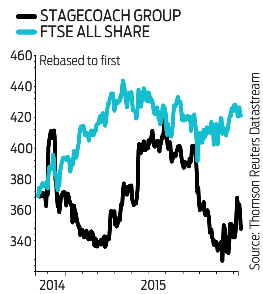
A 3 November decision by the QCS Review Board determined that the bus franchising scheme proposed by the North East Combined Authority (NECA) and Nexus, its transport executive, has failed to meet the necessary statutory tests.

Investec's Alex Paterson points out that this 'provides a comprehensive criticism of Nexus' proposed bus franchising scheme and made further recommendations which we suspect could raise the cost of regional devolution, resulting in more regional public/private partnerships.'

SHARES SAYS: ▲▼

At 351p high rail exposure, devolution and sluggish North American growth make the investment case for Stagecoach problematic.





Rotork update catalyst

Scope for a turnaround at engineering play

WILLIAM CAIN

LOOK OUT FOR a buying opportunity at oil services engineer **Rotork (ROR)** when it updates the market on current trading tomorrow (13 Nov).

Buying the dips and holding for the long term has proved profitable in the past for investors in the Bath-headquartered firm.

A profit warning on 17 September saw analysts at Investec downgrade the stock to a 'sell' and analyst Michael Blogg does not sound too optimistic ahead of the update.

'We have aimed towards the low end of the indicated ranges for revenue and profit and we expect 2016 to be tough as well,' writes Blogg in a 17 September note.

'In aggregate, this undermines the immediate value of the shares, notwithstanding Rotork's status as a strong and well-managed business.'

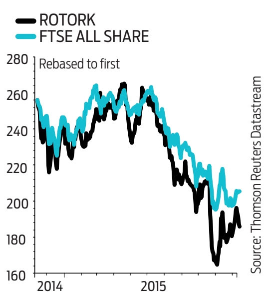
Blogg forecasts earnings per share of 10.1p this year (to 31 December 2015) and 10.2p the year after.

Historically, Rotork has rebounded strongly when its end markets stabilise.

While it is too early to call an end to the supply chain squeeze in oil and gas, investors should keep an eye out for any sign of a potential revival.

SHARES SAYS: ▲▼

At 186p we're cautious ahead of the update but like the business longer term.



RESULTS

FRIDAY 13 NOVEMBER	
Interims	
Auto Trader	AUTO
Castings	CGS
New Europe Property	NEPI
MONDAY 16 NOVEMBER	
Finals	
Diploma	DPLM
Interims	
Majestic Wine	MJW
Schroder Real Estate IT	SREI
TUESDAY 17 NOVEMBER	
Finals	
Enterprise Inns	ETI
EasyJet	EZJ
YouGov	YOU
Interims	
British Land	BLND
Big Yellow	BYG
Halma	HLMA
Homeserve	HSV
Intermediate Capital	ICP
McKay Securities	MCKS
WEDNESDAY 18 NOVEMBER	
Finals	
Xeros Technology	XSG
Interims	
Eckoh	ECK
HICL Infrastructure	HICL
NewRiver Retail	NRR
Picton Property Income	PCTN
THURSDAY 19 NOVEMBER	
Finals	
Euromoney Institutional	ERM
Grainger	GRI
Interims	
Close Brothers	CBG
Caledonia Investments	CLDN
Frutarom Industries	FRUT
Investec	INVP
Johnson Matthey	JMAT
MHP	MHPC
New World Resources	NWR
Premier Foods	PFD
Poundland	PLND
Royal Mail	RMG

TRADING STATMENTS

FRIDAY 13 NOVEMBER	
HellermannTyton	HTY
Rotork	ROR
MONDAY 16 NOVEMBER	
FBD	FBH
Green Reit	GRN
Keller	KLR
TUESDAY 17 NOVEMBER	
Devro	DVO
Paddy Power	PAP
WEDNESDAY 18 NOVEMBER	
Moneysupermarket.com	MONY
THURSDAY 19 NOVEMBER	
Centrica	CNA

AGMs/EGMs

FRIDAY 13 NOVEMBER	
Base Resources	BSE
Macau Property	MPO
MONDAY 16 NOVEMBER	
Avation	AVAP
Lekoil	LEK
Tanfield	TAN
Transense Technologies	TRT
Wolf Minerals	WLFE
TUESDAY 17 NOVEMBER	
B.S.D. Crown	BSD
Craneware	CRW
Eagle Eye Solutions	EYE
Global Petroleum	GBP
Madagascar Oil	MOIL
New World Oil & Gas	NEW
Smiths	SMIN
Spectra Systems	SPSY
WEDNESDAY 18 NOVEMBER	
Sabien Technology	SNT
THURSDAY 19 NOVEMBER	
Great Eastern Energy	GEEC
Genus	GNS
Ludgate Environmental Fund	LEF
Ruffer Investment Company	RICA
Sqn Asset Finance Income Fund	SQN
FRIDAY 20 NOVEMBER	
Celtic	CCP
Crystal Amber Fund	CRS
Ibex Global Solutions	IBEX
Red Emperor Resources	RMP
Peoples Operator	TPOP

EX-DIVIDEND

THURSDAY 19 NOVEMBER		
Balfour Beatty B	BBYB	4.84p
Braemar Shipping	BMS	9p
Bunzl	BNZL	11.75p
BlackRock North.AM	BRNA	1.1p
Carnival	CCL	0.3USD
Craneware	CRW	7.7p
Digital Globe	DGS	0.04USD
e2v technologies	E2V	1.6p
Edinburgh Dragon	EFM	3p
F&C Managed Port	FMPI	1.2p
Fidelity Special Val.	FSV	2.35p
Gleeson (M J)	GLE	7.3p
Genus	GNS	13.4p
GETECH	GTC	1.74p
Hill & Smith	HILS	7.1p
Imperial Tobacco	IMT	49.1p
Lok'n Store	LOK	5.67p
MedicX Fund	MXF	1.48p
Prime People	PRP	4p
Prime People	PRP	1.75p
Redefine International	RDI	0.33p
Redefine International	RDI	1.32p
Sanditon Investment	SIT	0.45p
Scottish Mortgage	SMT	1.38p
Spire Healthcare	SPI	1.3p
Tate & Lyle	TATE	8.2p
Tristel	TSTL	2.14p
Utilico Investments	UTL	1.88p
World Careers Net.	WOR	3.5p
Witan I. Trust	WTAN	3.85p
Whitbread	WTB	28.5p
FRIDAY 20 NOVEMBER		

FRIDAY 13 NOVEMBER ► RESULTS ► INTERIMS

Auto Trader (AUTO) 383p

SECOND HAND CAR online marketplace **Auto Trader (AUTO)** is set to report interim results on 13 November covering the six months to the end of September 2015.

Investors will be hoping the optimistic note sounded by car dealer **Vertu Motors (VTU:AIM)** alongside its own interims (14 October) are a positive sign ahead of this release.

Auto Trader joined the stock market in March and the shares have performed strongly since its flotation. Despite being in existence in one form or another since 1977, Auto Trader is now very much 'new media'.

The slightly dog-eared looking print product for which it was famous was discontinued in 2013 leaving the group 100% digital. Two thirds of its traffic is now generated through smartphones and tablets.

According to the company around 65% of used car transactions in the UK involve vehicles listed on autotrader.co.uk; 93% of UK consumers have used the site when vehicle shopping; and it accounts for 85% of the time UK consumers spend on automotive classified sites. (TS)

ECONOMICS

FRIDAY 13 NOVEMBER

UK
- Construction Output
- CB Leading Index

EU
- Flash GDP

US
- Retail Sales
- PPI
- Core Retail Sales
- Prelim UoM Consumer Sentiment
- Prelim UoM Inflation Expectations

MONDAY 16 NOVEMBER

EU
- Final CPI

US
- Empire State Manufacturing Index

TUESDAY 17 NOVEMBER

UK
- Unemployment Rate
- Claimant Count Change

EU
- ZEW Economic Sentiment

US
- CPI
- Industrial Production

WEDNESDAY 18 NOVEMBER

UK
- Public Sector Net Borrowing

US
- Housing Starts
- Building Permits
- FOMC Meeting Minutes

THURSDAY 19 NOVEMBER

UK
- Retail Sales

EU
- ECB Monetary Policy Meeting Accounts

US
- Unemployment Claims
- Philly Fed Manufacturing Index
- Mortgage Delinquencies

FRIDAY 20 NOVEMBER

EU
- Flash Manufacturing PMI
- Flash Services PMI
- Consumer Confidence

US
- Flash Manufacturing PMI

Source: Money am

12-MONTH PROFIT ON ALL 'PLAYS OF THE WEEK' TRADES: **+6.9%** VS. FTSE ALL-SHARE: **-4.5%***

Kennedy looks cheap

Micro cap miner set to enjoy big profit margins

DANIEL COATSWORTH

Want a hidden gem? It really defies belief as to why the market hasn't cottoned on to **Kennedy Ventures (KENV:AIM)**, but that gives *Shares* readers an opportunity to pick up a real bargain.

This little-known micro cap has the potential to be highly cash generative, although the shares are only suitable for someone with a big risk appetite. It has a tantalum mine in Namibia that has just started production. Kennedy says the mine should produce 5,000 pounds per month of tantalum oxide from the second quarter (Q2) of 2016.

LOOKING GOOD

A buyer has already been signed up for the entire production, namely an undisclosed US electronics manufacturer. They are paying \$80 per pound for the next five years; Kennedy is already smiling as the tantalum price is currently less than this amount at \$75 per pound.

The Q2 2016 target of 5,000 pounds per month multiplied by \$80 per pound equates to monthly revenue of \$400,000, or \$4.8 million on an annualised basis. When you convert the latter figure to pounds at current exchange rates (£3.18 million) and measure against the present £6.8 million market cap, it means the shares are effectively trading on a mere 2.14 times near-term sales.

By Q2 2017 it is hoped the mine will produce 9,200 pounds per month. On \$80 per pound selling price, the miner would generate \$736,000 a month or \$8.8 million annualised.

Chairman Giles Clarke says operating costs (including adviser fees) are estimated to be \$30 per pound, implying significant pre-tax profit margins for the group. Diesel is the biggest single cost, so Kennedy is looking at solar power opportunities to bring the energy bill down. Miners pay 5% royalty in Namibia and 35% tax. Kennedy is debt free.

Dividends look unlikely from the business, despite the potential cash generation strength. Clarke has his eyes on snapping up more tantalum mines so cash generated from operations will be reinvested into the group. Five acquisition targets have already been identified in Namibia and Mozambique is next on the shopping list. We'd heed caution with the latter territory as tantalum is known to be radioactive

in this country, but Clarke no doubt has a trick up his sleeve for making the material safe.

MONEY MAKER

The chairman has made lots of investors rich over the years. He built up **Majestic Wine (MJW:AIM)**, **Safestore (SAFE)** and a business that now forms a core part of **Pets at Home (PETS)**. Clarke is also part of the team that has turned **Amerisur Resources (AMER:AIM)** into one of the standout oil and gas stocks on the market.

Kennedy was a cash shell before buying the tantalum mine which had previously been developed by an Australian company before they ran out of money. Tantalum is used in electronic components such as mobile phones, laptops and television sets.

There is a rule in the US that requires electronic manufacturers to ensure raw materials used to make their products are not tied to conflict in parts of Africa.

Companies have to be able to trace and audit their supply to ensure raw materials are not financing violence in eastern Congo. That is why Kennedy's offtake partner has signed up for many years' supply, as it has undertaken due diligence on the company and certified it as 'conflict free'.

This supply agreement also gives Kennedy credibility should it need to obtain finance to buy more mines. It wants to avoid diluting shareholders by continuously issuing equity to fund expansion; instead it believes the business can be geared up thanks to the relationship 'with such a credible institution as an end buyer', says Clarke.

This looks an exciting stock in a bombed-out sector. We've imposed a wider than normal stop of 30% to account for sector volatility and Kennedy's unflattering 7.4% bid/offer spread.

KENNEDY VENTURES

(KENV:AIM) 6.5p

Stop loss: 4.55p

▲ BUY

Market value:
£6.8 million

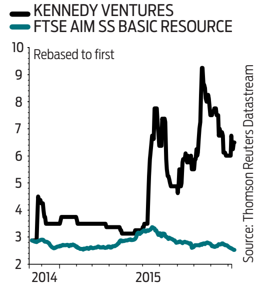
Prospective PE Jun 2016:
n/a

Prospective dividend yield:
n/a

Bid/offer spread:
7.4%

Analyst price target:
n/a

Previous Shares view:
n/a



Growth: MEDIUM
Earnings growth potential is good but from a low base.

Risk: HIGH
Single asset business not ideal, as any operational problem could cut off revenue flow.

Quality: MEDIUM
If all goes to plan, Kennedy will enjoy decent profit margins and generate cash to fund growth.

* FTSE All-Share comparative performance is from start of each Plays trade until present. The portfolio consists of 98 stocks and runs on a 12-month rolling basis. There are 74 open positions; we have taken profits or the stop loss has been triggered on the remaining stocks. In the past 12 months, the FTSE All-Share is down 2.7%.

BROKER RATING: ● SELL ● HOLD ● BUY ● NOT AVAILABLE

Spin a win with Nektan

Early-stage business is signing major contracts at a rapid pace

EMILY PERRYMAN

High profile contract wins, a $3 billion US market opportunity and high barriers to entry are good reasons to invest in mobile gambling company **Nektan (NKTN:AIM)** and take advantage of recent share price weakness.

The £30 million cap, whose shares have fallen 32.6% so far this year to 130p, is strongly positioned to capitalise on two major opportunities: signing up real money gaming partners in Europe and introducing its Xtraspin casino upgrade in the US.

DEAL WITH THE SUN

Nektan has made significant progress in Europe and is currently live with 29 real money gaming casino partners. In February the company signed a landmark multi-year contract with *The Sun* newspaper following a rigorous selection progress which saw it beat much larger players to win the deal. This is because Nektan has its own mobile gaming platform, Evolve, which enables it to get products to market much faster and at less cost than its competitors.

Real money gaming is the fastest-growing segment of the online gaming market and it has much higher margins than social – or 'freemium' – gaming which many of Nektan's competitors focus on. Nektan's chief executive David Gosen says the group plans to expand in the UK and in international regulated markets.

'The second driver is more content. We will increase the size of our portfolio; there is a correlation between the number of games you have and revenues,' says Gosen.

FIRST MOVER ADVANTAGE

Nektan has a first mover advantage in the US, where through its joint venture Respin it is upgrading casino slot machines with its Xtraspin product. Around 40% of the 651,000 slot machines in US casinos have reached the end of their contractual life which means they're no longer supported by the manufacturers. Slot machines cost between $20,000 and $100,000 to replace but Xtraspin enables the casino to upgrade them for just $12 a day. Gosen says casinos typically install 40 to 50 wheels when they sign on the dotted line.

Xtraspin is currently live in 12 casinos with 74 Xtraspin wheels installed. A further 22 casinos have contracted or signed letters of intent for an additional 130 Xtraspin wheels. Casinos have reported a 30% rise in slot revenues on the machines where Xtraspin is installed.

Gosen says the barriers to entry are high because in the US companies must be regulated with the state and with each casino, which is a lengthy process. Nektan is the only company in the US offering the slot machine upgrade option and Xtraspin has been granted a patent.

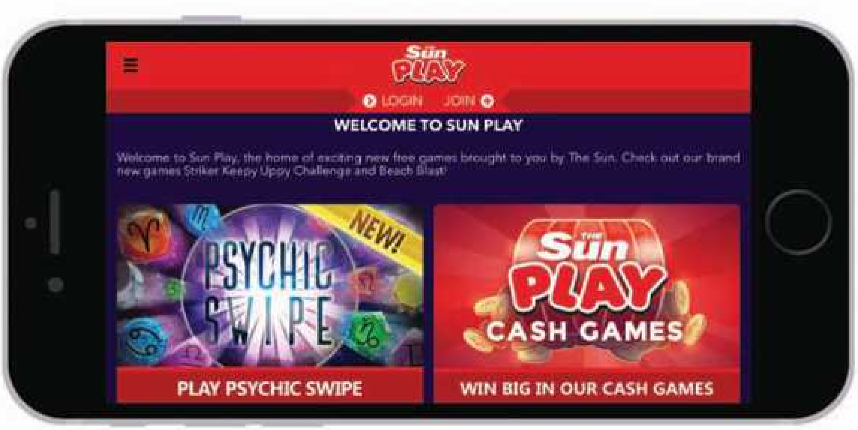
RISING REVENUES

Nektan is an early stage business which is still loss making but it is gathering momentum, with first quarter revenues for the current financial year surpassing the total revenues for the entire previous year.

A swing to profitability has been pushed back from 2016 to 2017 due to the group's delay in securing financing. It raised £8 million in April and May and a further £2.75 million in October to fund its expansion and support its working capital requirements.

Gosen has pretty much ruled out another cash call, saying the only reason it would be required would be in 'extraordinary circumstances, for example if we wanted to go into mergers and acquisitions or if we won a very significant contract in the US which required us to make hundreds of extra wheels'.

House broker Zeus Capital has a share price target in the range of 249p to 307p, implying upside of 91.5% to 136%.



NEKTAN
(NKTN:AIM) 130p
Stop loss: 104p

▲ BUY

Market value:
£29.6 million

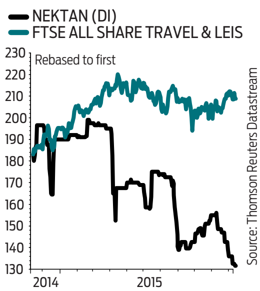
Prospective PE Jun 2016:
N/A

Prospective PE Jun 2017:
7.4

Prospective dividend yield:
N/A

Bid/offer spread:
3.7%

Analyst price target:
N/A

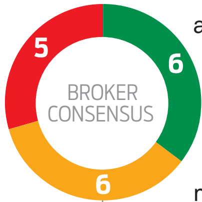


Growth: HIGH
Nektan is signing contracts in Europe and the US at an impressive pace.

Risk: HIGH
It is an early-stage business which operates in the tax and regulation-heavy gambling sector.

Quality: MEDIUM
Nektan's landmark deal with The Sun proves the quality of its real money gaming platform.

PETROFAC (PFC)



OUR BEARISH CALL on oil services firm **Petrofac (PFC)** has paid off. Although we don't necessarily think the pain is over for the company we feel it would be prudent to a book a quick double-digit profit given the levels of volatility in this sector.

We argued the shares had over-reacted to news that an unpopular move into the subsea construction market had potentially been canned. The company terminated a contract (9 Oct) with Shanghai Zhenhua Industries Company to build a new offshore services vessel, citing issues with the latter's performance.

In the interim its peers **Amec Foster Wheeler (AMFW)** (5 Nov) and **Hunting (HTG)** (4 Nov) have delivered downbeat updates to the market and oil prices have suffered a renewed downturn.

Amec's release was particularly damaging. The FTSE 250 group halved its dividend and warned on 2016 trading. Its assessment of the market made for very bleak reading. 'For more than a year – across many parts of our business – we have seen customers reducing capital expenditure and putting more pricing pressure on the supply chain. We see no sign of these trends changing,' says Amec chief executive Samir Brikho.

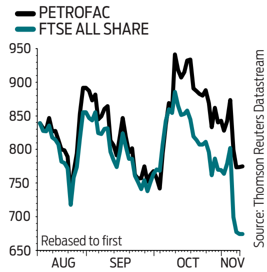
SHARES SAYS: ▲▼

We continue to see Petrofac as vulnerable although we're happy to close out a profitable short trade for now. (TS)

766p

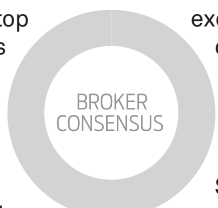
Gain to date: 16.7%

Original entry price:
Sell at 920p, 15 Oct 2015



15 for 2015 updates

RED24 (REDT:AIM)



FIFTEEN FOR 2015 pick Red24 remains a top performer year-to-date but interim results did not go down well with the market.

Shares in the micro cap security outsourcer plunged from highs of 28p on Friday to 20p as *Shares* went to press.

Revenue declined 7% in the six months to 30 September 2015 as Red24's big contract with **HSBC (HSBA)** ended. House broker FinnCap continues to forecast revenue growth for the full year as sales comparatives become weaker in the second half.

Underlying revenue growth in the first half, excluding HSBC, was at least 11%, by our calculations.

Profit-before-tax dipped 29% to £346,000, almost entirely explained by losses on a foreign exchange hedge. A chunk of Red24's costs are incurred in South African rand through a Cape Town-based service centre. The hedge aimed to guarantee these costs didn't rise if the rand appreciated against sterling, chairman Simon Richards tells *Shares*.

But the currency weakened rather than appreciated against sterling in the period causing losses on the hedging contract, therefore reducing the benefit of lower costs by around £100,000.

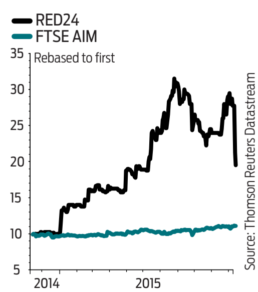
SHARES SAYS: ▲▼

We highlighted some time ago Red24 faced a tough 2015/16 but will continue to run the pick for the remainder of the year. (WC)

20p

Gain to date: 100%

Original entry price:
10p, 23 Dec 2015



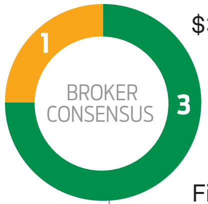
WENTWORTH RESOURCES (WRL:AIM)

TANZANIAN GAS PRODUCER **Wentworth Resources (WRL:AIM)** continues to deliver, enjoying strong gains as it receives a first payment for delivery from its Mnazi Bay field into a newly built trans-national pipeline (4 Nov).

We like the company because it is insulated from volatility in the oil price – it gets a regulated price of $3.07 per thousand cubic feet for its gas. This price is set to rise in line with US CPI industrial index from 2016.

Mnazi Bay gas is currently being used to generate power in Dar es Salaam at the existing Ubungo-II and Symbian power plants, as well as at the new Kinyerezi-I power plant.

The company has received a gross payment of $3.8 million for its October gas deliveries and expects to lift production volumes from the current 33 million cubic feet per day to 80 million cubic feet per day.



The progress the company is making underpins forecasts from stockbroker FinnCap which suggest Mnazi Bay could generate $28 million a year of free cash flow. This cash could be reinvested at an opportune moment in the industry cycle when costs are low and asset valuations are depressed.

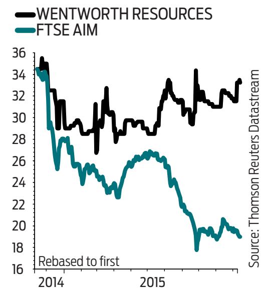
SHARES SAYS: ▲▼

Cantor Fitzgerald has a price target of 57p and we continue to see scope for upside from current levels. (TS)

33.3p

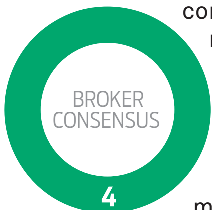
Gain to date: 25.7%

Original entry price:
Buy at 26.5p, 26 Feb 2015



REDCENTRIC (RCN:AIM)

INVESTORS MIGHT WELL be left scratching their heads, we at Shares are bemused. Interim results from managed services communications and IT supplier Redcentric (RCN:AIM) were pretty much bang on track yet the stock is off 4.5% to 187.75p since the figures on 9 November. The answer seems to be higher net debt of £16.5 million, and a slightly poorer cash flow performance, both a consequence of April's £12 million Calyx acquisition. Neither looks an issue to us. Integration benefits will come through in the coming months while solid cash generation (£9.4 million underlying in the period) will help quickly pay down borrowings. Redcentric, a Play of the Week on 27 August at 180p, continues to look well-placed in the mid-market space, 15% headline revenue growth translates into 8% organic, and important underlying recurring income (81% of £54 million revenue) increased 12%, providing the sort of visibility many businesses would envy. With most of its £70 million loan facilities still untapped, expect further forays into the M&A space, which should please shareholders given the company's splendid track record to date.



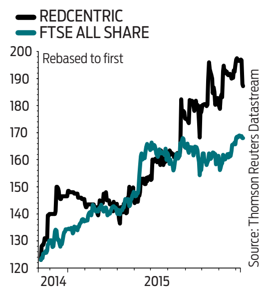
SHARES SAYS: ▲▼

Execution of the growth plan is first rate and even at 250p, the March 2017 price to earnings (PE) multiple would be a deserved 20.8. We remain positive. (SFr)

187.75p

Gain to date: 4.3%

Previous *Shares* view:
Buy at 194.75p, 8 Oct 2015



IS YOUR INCOME SAFE?

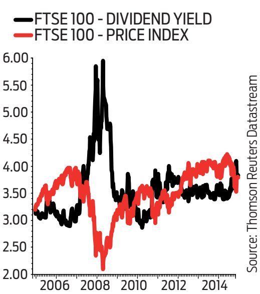
DANIEL COATSWORTH

How safe is your income from the stock market? There are some worrying statistics that suggest many of the biggest companies in the FTSE 100 index may be forced to cut their dividends due to cash flow and debt pressures. This would be very bad news for anyone who draws an income from UK equity investment funds or owns some of the UK's most popular stocks.

Lower dividend payments means less cash in your pocket. It could also make the respective companies less attractive to lots of investors, prompting them to sell their stock in search of alternative income stocks. That in itself would force down share prices and put a dent in the value of your investments if you held the same dividend-related stocks.

The FTSE 100 currently trades on a 3.8% dividend yield, according to the London Stock Exchange-owned FTSE Group. That is based on historical data (last reported financial year), yet in contrast if you look at forecast yield information there are plenty of blue chip companies expected to yield between 5% and 7%. Is that too good to be true?

A high yield often results from a depressed share price – if a share price falls but dividend forecasts stay the same, the yield will rise. And why would a share price fall? Principally because the market believes the company is going through a difficult period and that earnings forecasts are too high. The result can often be dividend cuts.

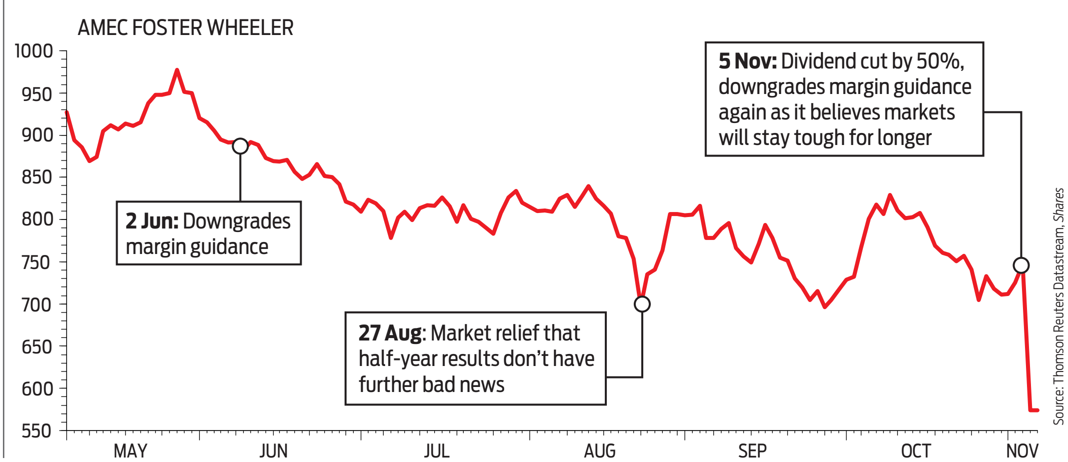


DIVIDEND CUTS HAVE ALREADY STARTED

FTSE 100 members **Glencore (GLEN)**, **Standard Chartered (STAN)**, **Tesco (TSCO)**, **Sainsbury's (SBRY)** and **Centrica (CNA)** have all cut or scrapped their dividend payments in the past year.

Travel and leisure group **TUI (TUI)** disappointed investors in October when it admitted the promise, made at the time of its merger with TUI Travel a year ago, of lifting dividends by at least 10% in excess of underlying earnings growth wasn't the new long-term policy. The payout boosts now appear to be bonuses just for 2015 and 2016, forcing analysts to downgrade subsequent dividend forecasts.

In the FTSE 250, oil services group **Amec Foster Wheeler (AMFW)** on 5 November told shareholders it would have to slash its dividend in half. A day earlier, miner **Vedanta Resources (VED)** scrapped its half-year



dividend – despite generating $1.3 billion of free cash flow – to focus on repairing its balance sheet.

WHO WILL BE NEXT TO CUT DIVIDENDS?

Key names now in the frame for potential dividend freeze, cut or cancellation include **Royal Dutch Shell (RSDB)**, **BP (BP.)**, **GlaxoSmithKline (GSK)**, **HSBC (HSBA)** and **Anglo American (AAL)**.

Payouts from these five names account for approximately 34% of the dividend cash forecast to be paid by FTSE 100 constituents in 2016, so any reduction to their dividends would have an adverse effect on tens of thousands of investors' wealth. These are all major names in UK equity income fund portfolios, so this dividend cut risk is a significant issue for investors across the country.

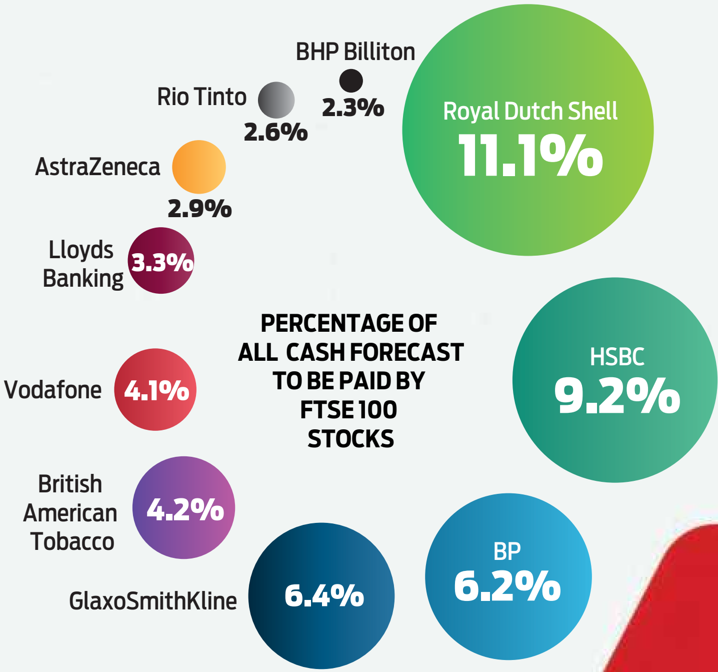
We debate the ability of many FTSE 100 companies to pay cash dividends in this article.

If you do not want to put your money at risk by having large exposure to these stocks, we reveal alternative selections for obtaining dividends such as **National Grid (NG.)** and **Next (NXT)**.

We also unveil a list of income funds least exposed to the FTSE 100 stocks most at risk of a dividend cut. Key names include **CF Miton UK Multi Cap Income (GB00B6919195)** and **Marlborough Multi Cap Income (GB00B42TBF45)**.

PROMISES, PROMISES

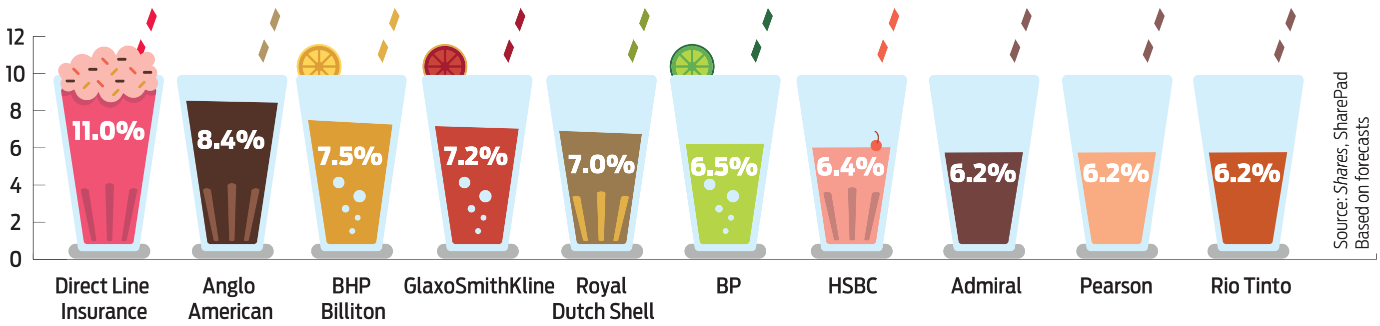
Many companies will go to great lengths to reassure



investors that dividends will continue to be paid. Yet no investor can be certain of a dividend until the cash is in their pocket. You must understand that companies have no obligation to pay dividends.

Just look at oil producer BP; it explained a plan to shareholders on 27 October for how it will sustain dividend payments despite cash generation pressures. Although that provided some comfort to the market, theoretically BP could announce tomorrow that it has changed its mind, something that cannot be ruled out if oil prices experience another downwards slump.

FTSE 100 FAT DIVIDEND YIELDS – DO THEY NEED TO GO ON A DIET?



HOW DO I SPOT IF A DIVIDEND IS SUSTAINABLE?

Dividends are paid out of a company's cash position. As a general rule, investors should take this view of a payout:

- Dividends funded by cash generation from operations = good.

- Dividends funded by cash reserves = not ideal, unless it is an investment trust. These funds are able to store cash for a rainy day so as to be able to continue paying dividends when times are tough for some of their underlying holdings.

- Dividends funded by debt = bad. This is like paying your monthly mortgage bill with a credit card or personal loan. If done in perpetuity, you would end up owning an asset (the house) but still have a liability (the credit card or personal loan) to settle. There is a chance that the cost of servicing the credit card debt might have been lower than the mortgage rate, but that still leaves you with borrowings to clear.

- Dividends funded by retained earnings = bad. You can raid the piggy bank, but the cash runs out eventually unless you top it up with newly-generated earnings.

One of the most popular ways to judge a company's ability to pay dividends is to match the shareholder payout against the earnings per share (EPS) figure. Dividend cover is EPS divided by DPS (dividend per share).

For example, **Whitbread (WTB)** made 204.81p EPS in its most recent financial year and declared 82.15p in dividends for the 12-month period. That gives it a dividend cover of 2.5.

Dividend cover 'rule of thumb':

- A figure above 2 suggests the company has ample room to pay its dividend and to also grow its dividend in the future.

- A figure less than 1.5 may indicate danger of a dividend cut.

- A figure below 1 indicates a company is paying the current year's dividend with retained earnings from a previous year, or funding it with debt – a practice that cannot continue indefinitely.

Dividend cover is an extremely important red or green flag – not just for the company's ability to pay cash rewards to shareholders, but also its general state of health.

Think about why a company pays a dividend. That is meant to be excess cash to the needs of the business – after accounting for money that is needed to be reinvested in the company to ensure it stays competitive. A good company is one that has a business model capable of generating excess cash. It pays dividends as a reward to shareholders for supporting the business.

A company which decides to lower the level of dividend payments or cancel completely is theoretically one which is making a statement to the market about health concerns. Managers should have their eye on the future when deciding the level of dividend to pay, so any negative change to the dividend is a red flag.

It could either mean trading problems, balance sheet issues or – in rare situations – a need to use cash for an acquisition. The latter wouldn't necessarily be a red flag if the acquisition can drive shareholder value in the future.

THERE ARE MAJOR WARNING SIGNS

The Share Centre says dividend cover for the

FTSE 350 index has hit a near six-year low as UK plc profitability dwindles. At a ratio of just 1.2, this figure (the most recent data, relating to the first quarter of 2015) is nearly half the level recorded two years earlier.

The stockbroker calculates its dividend cover ratio as profit after tax divided by dividends paid. This is essentially the same as the EPS calculation earlier in this article; EPS being net profit after tax divided by the number of ordinary shares in issue.

Oil and gas companies and consumes services businesses saw the largest falls in their dividend cover, blamed on a falling oil price and supermarket price war respectively. Oil and gas firms now stand at a mere 0.7 times dividend cover; consumer services at 0.6. Normally defensive health care stocks are also in danger territory with 0.9 times cover; utilities are particularly sick on 0.5 times cover.

Capita Asset Services has published more up-to-date data on the state of UK dividends, saying they hit £27.2 billion in the third quarter of 2015. That's a record for the three-month period and the third largest quarterly sum ever paid. That paints a bullish picture, so why are we concerned?

The headline figure was flattered by a number of special dividends – one-off payments in addition to 'normal' dividends – from the likes of **Direct Line Insurance (DLG)** and housebuilder **Taylor Wimpey (TW.)**. Excluding special payments, dividends rose 5.9% year-on-year in the quarter to £25.8 billion, a slowdown on the 7.9% growth in the first half of the year. That is heavily influenced by Tesco's dividend cancellation and Sainsbury's dividend cut.

Capita believes 2016 will

see 'sharply slower growth' in dividends for UK equities, with FTSE 100 stocks lagging FTSE 250 mid cap stocks. While that paints a gloomy picture, it not particularly bearish on the stocks most vulnerable to a dividend cut.

The FTSE 100 is populated with numerous natural resources companies, all of whom are struggling with dramatically lower commodity prices over the past few years. High levels of debt across the industry have put pressure on oil, gas and mining firms to find ways to cut costs and sustain cash generation in order to service borrowings. A lot of the sector has already slashed shareholder cash rewards; the majors must surely be giving serious thought to rebasing their dividends as well. Yet Capita notes that FTSE 100 miners **BHP Billiton (BLT)** and **Rio Tinto (RIO)** have reaffirmed their intention to continue progressive dividend policies.

Capita says speculation that Royal Dutch Shell may cut its dividends is 'overblown'. It comments: 'as the largest dividend payer in the world (according to Henderson Global Investors Global Dividend Index), Shell's actions matter for the UK dividend pot more than any other stock. Oil prices are low, and Shell is cutting costs and capex rapidly to preserve cash.

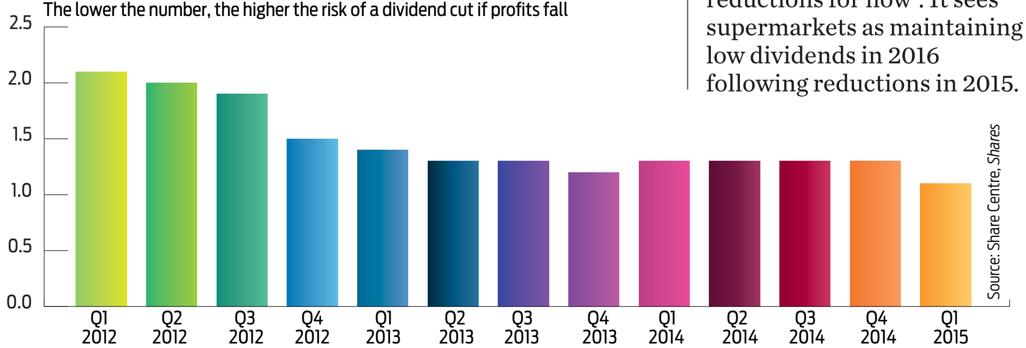
'It has not cut its dividend since the Second World War, and even though dividend cover (the ratio of profits to dividends) is very low, we expect the company to maintain in dollar terms what it pays to investors. The sterling value will depend on the fluctuation in the exchange rate. BP will attempt to follow suit and also resist pressure to reduce its own payout.'

Furthermore, Capita acknowledges that HSBC's dividend payout is vulnerable to a cut, but it is 'not pencilling in any reductions for now'. It sees supermarkets as maintaining low dividends in 2016 following reductions in 2015.

FTSE 100 DIVIDEND COVER IS SHRINKING

Dividend cover = profit after tax divided by dividends paid

The lower the number, the higher the risk of a dividend cut if profits fall



WHY YOU SHOULD STUDY CASH FLOW STATEMENTS

Using earnings per share and post-tax profit to determine dividend cover is helpful, but not foolproof. As we said earlier in this article, it is cash that pays the dividend so it is important to study the cash flow statement of a company as a litmus test for dividends.

Earnings per share can be manipulated via profit smoothing (profits being stored away in good years and released in lean years); and aggressive accounting, namely recognising sales in the profit and loss account while not recognising the costs. Asset disposals can also inflate earnings per share, in doing so they distort the true health of a business and therefore its ability to keep paying dividends.

GlaxoSmithKline's current cash flow profile is inadequate to cover its dividends, hence why many people are calling for the drugs giant to rethink its payout policy. Earnings are under pressure from patents expiring on blockbuster drugs, paving the way for cheaper generic drugs to hit the market.

Data from Exane BNP Paribas illustrates the cash flow problem and how the situation is unlikely to remedy itself in the coming years unless the dividend gets cut.

Free cash flow is cash generated from operations minus capital expenditure, net financial items and tax paid. It shows the amount of cash left to pay dividends, acquire other companies, reinvest in the business, buy back shares, and so on.

GlaxoSmithKline has pledged to pay 80p annual dividend for the next three years and pay 20p special dividend in April 2016. Exane believes dividend growth beyond 2017 will remain barely covered and that its net debt position will remain far higher than peers.

The situation could get worse if partners exercise put options on the ViiV and Consumer joint venture businesses, with circa 10% stakes valued at between £1 billion and £1.5 billion each – forcing GlaxoSmithKline to buy these stakes. Exane also believes **Novartis (NOVN:VTX)** could exercise its put option on a 36.5% stake of the Consumer business as early as 2018. Exane has a £11.2 billion valuation on this asset. How would it fund such items? These events put GlaxoSmithKline's dividend firmly at risk.

FINDING A SOLUTION

BP has unveiled a plan for 'balanced cash flows' by 2017 assuming oil trades at $60 per barrel. It says the dividend is sustainable in this scenario, but who is to say oil will recover to that level? The black stuff presently trades at a little below $50 per barrel; the global supply surplus is bigger than previously thought; and there are

GLAXOSMITHKLINE'S DIVIDEND DILEMMA

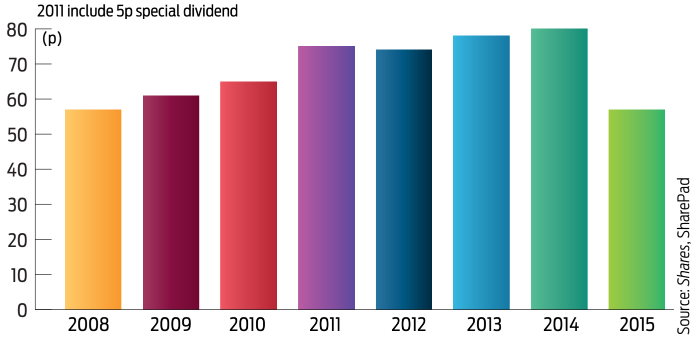
This is a rough analysis to illustrate how free cash flow is inadequate to cover dividend payments

£m	2013A	2014A	2015E	2016E
Operating cash flow	8499	6284	4388	5502
Capex	-1701	-1751	-2045	-1799
Net financial items + tax paid	-1667	-1747	-260	-1264
Free cash flow	5131	2786	2083	2440
Dividends	-3918	-4048	-4047	-5171
Balance	**1213**	**-1262**	**-1964**	**-2731**

Source: Shares, Exane

GlaxoSmithKline dividend trend

2015 is only 3 quarters' dividends declared so far
2011 include 5p special dividend



growing risks the oil price will stay low for longer.

In September, Macquarie published financial forecasts for BP which implied the oil producer wouldn't generate enough free cash flow to cover its dividends until 2018.

'A key reason for investing in the integrated oil companies is the attractive dividend yield normally available,' wrote the investment bank. 'Despite the companies insisting that payment of dividends is the first priority, there is some risk that a long period of low oil prices could see these reduced. Having said that, given the reduction BP already took in its dividend in 2009/10, when the payout was cut to zero and then restored at half the original rate, we think BP would be unlikely to be forced off its current policy.'

Investors are now being told to trust the company's word that it will continue dividends in their current form, aided by the drive for cost savings and reduced guidance for capital expenditure. In reality, investors are taking on extra risk for the continued uncertainty over the dividend, so the rewards should be proportionately high.

Is a 6.5% prospective dividend yield really enough reward? Analysts aren't exactly falling over themselves to forecast price targets much higher than the present trading level. The consensus target price

(the goal for the next 12 months) is 409p according to data from SharePad, which implies 1.4% potential upside. Total shareholder return would therefore be 7.9% which we believe is an inadequate return given the current risks surrounding earnings and the dividend.

SUMS DON'T ADD UP

Royal Dutch Shell is trading on a prospective 7% dividend yield. It made a $9.1 billion pre-tax loss in the third quarter of 2015 but generated $11.2 billion in cash. When you take into account capital spending, Royal Dutch Shell is unlikely to make enough cash to cover this year's dividend but it can continue the payout by increasing debt levels. You might forgive the business for going down this route as a short-term measure, but this is really bad practice unless it can accelerate cash generation.

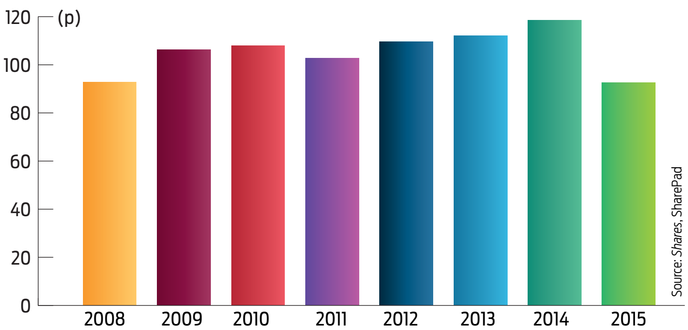
'Shell's third-quarter loss will be particularly worrying for income seekers, even if the red ink is largely the result of one-off items related to write-downs on exploration projects. Shell is forecast to be the highest dividend-paying stock in 2016, accounting for 11% of the FTSE 100's total cash payout,' says Russ Mould, investment director at AJ Bell. 'Although it has maintained its quarterly dividend at US$0.47 for Q3, the results show the company will have to work very hard to maintain this in the current oil price environment. This may be one reason why Shell is only held by three of the top 10 performing income funds.'

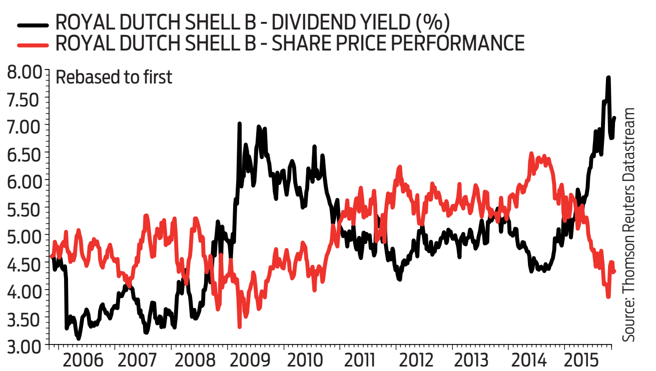
Deutsche Bank says the Q3 results emphasise 'just how poorly' Royal Dutch Shell is positioned to cope sustainably with $50 per barrel oil price. It believes the key to resolving its problems is to complete the acquisition of **BG (BG.).**

'Over the past four quarters crude has averaged $61 per barrel and Shell has delivered some $34 billion of CFFO (cash flow from operations) including $10 billion of working capital release but after $5 billion of CCS (current cost of supplies) losses,' says Deutsche Bank. 'Strip the working capital and add the CCS loss and the implication is the business has generated $29 billion in underlying

Royal Dutch Shell dividend trend

2015 is only 3 quarters' dividends declared so far





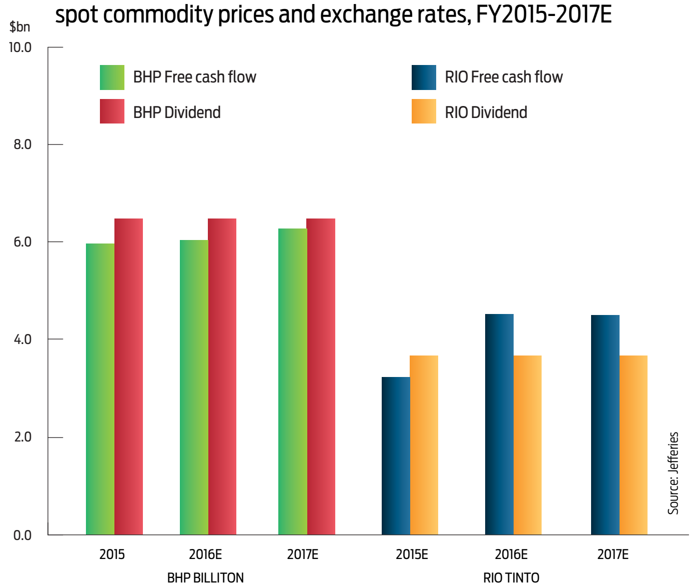
CFFO. Against this the company has current cash commitments of c$12 billion for dividends and $30 billion for capex. Take commitments from cash flow and if organic CFFO is to cover commitments, $13 billion is the shortfall. The cash cycle doesn't balance.'

That makes for horrible reading. So why has Deutsche Bank got a 'buy' rating on the stock? It believes everything will be different when BG is part of the team. It says Royal Dutch Shell will become a better business, the dividend will be funded and yield a more realistic 5.75%. The risk is that the BG deal fails to complete.

CUT AND SPEND

Jefferies analyst Christopher LaFemina has proposed that big miners BHP Billiton and Rio Tinto cut their dividends, presently yielding 7.5% and 6.2% respectively. While they have fairly decent balance sheets to follow the oil sector's flexible approach to dividends, he believes they should free up some cash to go on shopping sprees at the low point in the commodities cycle.

BHP Billiton and Rio Tinto's dividend and free cash flow at current spot commodity prices and exchange rates, FY2015-2017E



'Dividend payments that absorb all of a company's free cash flow may support share prices in the short-term, but we do not believe they create long-term shareholder value,' says the analyst.

Rio Tinto has the best free cash flow profile of the two businesses, in terms of generating more cash than is required to fund the dividend from 2016 onwards. Yet neither firm is forecast to have enough cash left over to invest in growth unless commodity prices go higher, they either take on more debt to fund investments or they cut their dividends. 'We would argue that balance sheets should be sacred for these companies, and using debt to fund a dividend and/or growth is not an attractive option,' says LaFemina.

UK EQUITY INCOME FUNDS THAT DO NOT HAVE LARGE OIL, GAS AND MINERS IN THEIR TOP HOLDINGS

Cumulative Performance	1 year	3 years	5 years	Yield
CF Miton UK Multi Cap Income	20.2%	78.3%	n/a	3.7%
Marlborough Multi Cap Income	15.3%	69.6%	n/a	4.3%
PFS Chelverton UK Equity Income	16.7%	66.9%	104.1%	2.4%
MFM Slater Income	16.0%	64.9%	n/a	3.8%
Standard Life UK Equity Income Unconstrained	13.9%	63.0%	87.9%	3.7%
Unicorn UK Income	13.8%	62.7%	109.1%	3.5%
Montanaro Equity Income	18.8%	59.1%	75.1%	3.8%
Ardevora UK Income	15.1%	56.5%	n/a	3.3%
HL Multi Manager Income & Growth	8.8%	45.9%	64.9%	4.1%
Evenlode Income	9.4%	44.8%	75.2%	3.8%
Trojan Income	13.7%	44.4%	75.3%	3.7%
Liontrust Macro Equity Income	7.8%	42.0%	51.8%	4.1%
Rathbone Blue Chip Income & Growth	10.2%	40.3%	55.9%	3.8%
Querns Monthly Income	5.8%	38.4%	56.0%	4.6%
Kames UK Equity Income	10.4%	36.4%	50.9%	4.4%
CF Canlife UK Equity Income	12.2%	36.3%	48.8%	4.9%
ConBrio B.E.S.T. Income	13.2%	36.2%	39.0%	4.2%
Close OLIM UK Equity Income	8.1%	33.2%	52.0%	3.7%
HC KB Enterprise Equity Income	4.9%	32.2%	42.5%	2.4%
Newton UK Income	7.2%	30.8%	42.2%	3.9%
L&G UK Equity Income	6.2%	30.4%	n/a	3.9%
Neptune Quarterly Income	9.4%	29.9%	41.8%	3.1%
Henderson UK Strategic Income	6.9%	29.7%	46.3%	3.2%
Neptune Income	6.2%	22.7%	30.3%	5.1%
CF Woodford Equity Income	19.9%	n/a	n/a	4.0%
Investec UK Equity Income	n/a	n/a	n/a	3.7%
Old Mutual Woodford Equity Income	n/a	n/a	n/a	n/a

Source: Trustnet, *Shares*, Morningstar, Fund factsheets

ARE THERE INCOME FUNDS THAT AVOID THE RISKIER FTSE 100 STOCKS?

If all this stock analysis makes for bleak reading, there are plenty of alternative routes to generate an income from mid to large cap stocks.

Trustnet has filtered the market to identify funds that do not invest in the big oil, gas and mining companies. It has specifically selected Anglo American, Rio Tinto, BHP Billiton, BP, Royal Dutch Shell, as well as HSBC, as the stocks not to appear in any fund's top 10 holdings, being the companies implied by the latest Capita dividend monitor as being most at risk of making dividend cuts.

The result is a list of 27 funds which we have ranked by three-year performance figures in the accompanying table. The best performer has been CF Miton UK Multi Cap Income, up 78.3% over the past three years and offering a 3.7% dividend

yield. The collective is run by fund manager Gervais Williams, in conjunction with Martin Turner. It has a bias towards mid and small cap companies although the top 20 holdings do include FTSE 100 constituent Direct Line.

Other standout performers that avoid the big oil, gas and miners include Marlborough Multi Cap Income which has a FTSE 250 bias but does have large positions in utilities **SSE (SSE)** and National Grid. We flag **MFM Slater Income (GB00B6YSXJ10)**, up 64.9% over the past three years and yielding 3.8%, which has three FTSE 100 stocks in its top 10 holdings: **Imperial Tobacco (IMT)**, **Legal & General (LGEN)** and **AstraZeneca (AZN)**.

We also flag **Neptune Income (GB0032325093)** with a 5.1% prospective yield, according to Morningstar data. It includes overseas-listed stocks including **Microsoft (MSFT:NDQ)** but does have quite a few FTSE 100 names in the top 10 holdings. Relevant stocks include **Diageo (DGE)**, **Prudential (PRU)**, **WPP (WPP)** and **British American Tobacco (BATS)**.

HIGH YIELD: TOO GOOD TO BE TRUE?

We have run the data on forecast earnings and payouts to get an overview of the prospective dividend yields currently on offer from FTSE 100 firms. Anglo American has the biggest yield at 8.4% and that is almost certainly going to have to cut its dividend due to cash flow issues. The market has long priced in a big cut, hence the high prospective yield.

Insurance group **Admiral (ADM)** trades on a 6.2% yield. The payout looks generous – and has been for some time – due to the addition of special dividends. Its policy is to pay 45% of post-tax profit and the available surplus capital above required regulatory levels plus an appropriate buffer as the special element.

Investors must recognise a risk to this chunky dividend from a new regulatory framework called Solvency II which comes into force next year. This new pressure on insurance companies could force them to rethink the generosity of dividends. Although life insurers are expected to feel the pinch the most, the general insurers which includes Admiral are still mindful of the new capital requirements. For example, Direct Line on 3 November flagged Solvency II as being a consideration for future return of capital to shareholders.

Direct Line comes out as the biggest prospective dividend yield in the FTSE 100 at 11%. That is slightly misleading as it includes a special dividend for 2015 that is expected to be greatly reduced in subsequent years. Excluding special dividends, Direct Line is more of a 4% yielder.

Publishing and education group **Pearson (PSON)** looks a prime candidate to cut its dividend, presently yielding 6.2%, following a profit warning in October. *Citywire* subsequently quoted **Lindsell Train Investment Trust (LTI)** fund manager Nick Train as saying that he would sell Lindell's 3.08% stake in the FTSE

100 group unless there is an improvement in the strategy, suggesting a two-year dividend suspension may save the group £800 million to be used for investment in the online operations and reduce debts.

SURELY VODAFONE'S DIVIDEND IS SECURE?

Vodafone (VOD) presently trades on a 5.3% prospective yield. This income appeal is a key reason why so many investors hold the stock in their portfolio. The telecoms giant is in the second year of its two-year 'Project Spring' investment strategy, focusing on 3G/4G expansion and fibre. Macquarie bank recently turned bullish on the stock, saying the outlook is getting better. It notes the positive combination of European improving service revenue trends, growth returning to Europe, the end of Project Spring and a cost focus as likely catalysts to drive the share price.

Berenberg bank is also bullish on the stock. It says: 'the shares remain among the best positioned to benefit from the key themes of mobile data monetisation, mobile market repair, and mobile market consolidation (c50% of group EBITDA is derived from markets which have already seen some form of consolidation announced).'

It is the end of a period of significant capital expenditure that gives us comfort in Vodafone's abilities to generate more cash than is required to pay the dividend – but that situation isn't in place until 2017. Therefore investors shouldn't assume Vodafone's dividend is low-risk at present. If the benefits of Project Spring do not materialise and/or the business keeps buying fixed line assets at high multiples, the debt pressures on Vodafone could reach danger territory and put a question mark over the dividend.

Anyone looking for more secure dividends should consider utilities transmission giant National Grid, a highly defensive stock offering a 4.8% prospective yield. We also favour retailer Next with a 5% prospective yield, although caveat that this includes forecast special dividend payouts. It is a well-run business with a strong track record of returning surplus cash to investors. Take away the special dividend forecast and you are left with 2% yield, less attractive but this is also a capital appreciation story where you should be rewarded with a rising share price which, combined with the income, offers the potential for robust shareholder returns.

PROSPECTIVE DIVIDEND YIELD

PEARSON 6.2%

TOO GOOD TO BE TRUE?

How EE will reshape BT

CMA clears way for £12.5 billion deal that promises huge telecoms disruption

STEVEN FRAZER

UK telecoms giant **BT (BT.A)** is firmly back in the mobile market after its swoop to buy UK mobile network EE was effectively cleared by the Competition and Markets Authority (CMA). The merger means BT will have a fully-owned, quad-play service, but the bottom line for investors is that it will leave the group with the most compelling bundled package for consumers, and allow huge cost savings across the operation, putting real growth back on the cards, bolstering margins and underpinning future dividends. No wonder the share price has rallied more than 14% in six weeks to 461.75p.

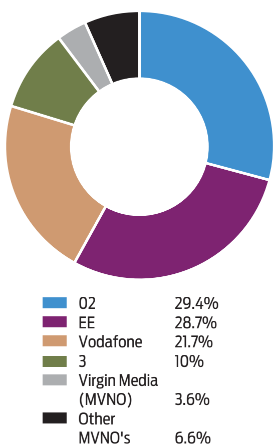
Buying EE represents a next phase of a huge transition for BT having stormed on to the digital TV landscape by buying 'live' rights to screen some *Premier League* football matches in June 2012, and snatched 'live' *UEFA Champion's League* football from the clutches of rival **Sky (SKY)** in November the following year. It has since bolstered its movies and TV box sets offerings as well.

'The CMA found that there was no substantial lessening of competition in any of the market segments,' explain analysts at investment bank UBS. 'The prospect of limited deal remedies is positive for BT.'

BT has been eyeing the mobile space for some time, as first revealed by *Shares* on 3 July 2014, and actually re-launched its mobile package in June, although that was via a mobile virtual network operator (MVNO) agreement, also with EE. Buying its on-the-go communications supplier outright will have far-reaching implications for the group, the telecoms market, and for shareholders.

'We think clearance of the BT/EE deal will be positive for sentiment for the broader sector as investors re-focus on the prospect of further mergers and acquisitions (M&A),' say UBS analysts. 'We remain positive on European telecoms and believe recovery/operational gearing in the sector has been underestimated.' UBS says its own equity strategy for the sector is to focus on mobile centric companies based on the potential for upside from mobile data growth.

Subscriber market share (June 2015)

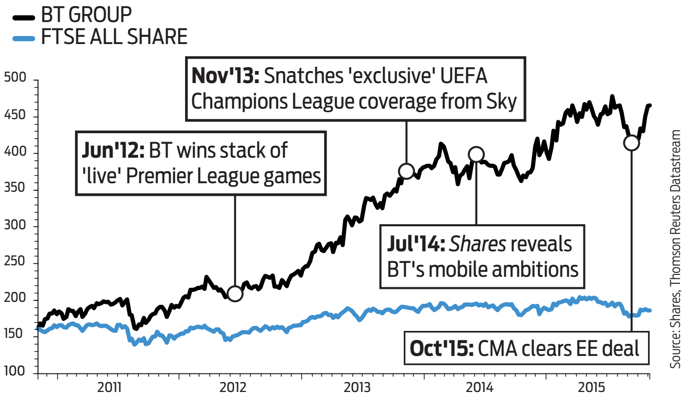


Source: Company reports, RBC Capital Markets estimates

UK NUMBER ONE

Tying EE into the BT family will make the group Britain's number one telco service supplier, with enormous market share. It already controls around 31% of the fixed-broadband market, according to Ofcom figures, as well as 37.6% of home phone traffic. This merger would add EE's 28.7% (by subscriber numbers) mobile market share to the portfolio. The similar merger of the UK arms of Orange and T-Mobile, producing EE, in 2010 saw the company take an immediate and commanding market lead. The company dominated the industry to the extent that in the 2012 auction of 4G spectrum bandwidths, Ofcom had to step in to prevent smaller companies like Three from being muscled out altogether.

Rival companies are already complaining that this deal would provide BT with an unfair competitive advantage. 'We strongly believe the combination of the UK's dominant supplier of digital fixed infrastructure, on which all other providers rely, with the largest mobile operator would have a negative impact on the market and the services

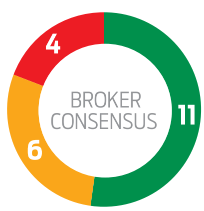


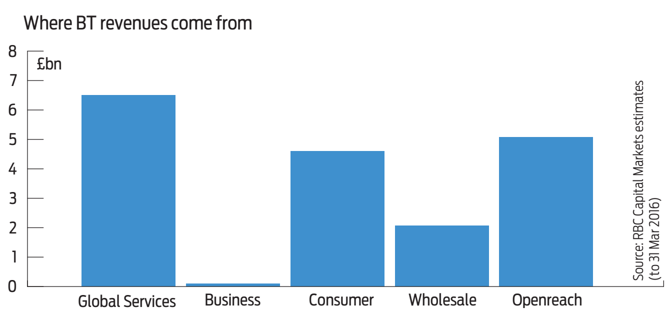
available to millions of UK consumers and businesses.' So read a statement from **Vodafone (VOD)** in response to the CMA's decision, and it is not alone. Similarly, a spokesman for **TalkTalk (TALK)** revealed the group's own concerns by the decision, adding that it would be studying the watchdog's findings before reporting back.

PRICES RISING

Another potential implication of the deal is the looming spectre of network price increases. BT will need to recoup the £12.5 billion outlay, and while some of the asking price will be met by new shares, around £7 billion is likely to come from existing cash resources and new debt facilities. That may be bad news for consumers, but represents a change for the better as far as investors are concerned.

'Historically the UK mobile market has been tough for operators with price competition from Three and numerous MVNO's with relatively large scale,' says RBC analysts. 'More recently operators have started to push through inflationary price increases,' the investment bank's experts confirm. Added to this, BT also reckons it can extract significant savings from the deal, streamlining IT, for example, to a more centralised service. Such





efficiencies have been valued at approximately £5 billion, according to analysis by Barclays, so it looks a fairly certain that the group will hope to pass on some of the extra costs to subscribers. And it has a good recent track record for doing so, pushing through price increases of its home phone and broadband packages to help meet the expense of its foray into sport.

The obvious concern for shareholders is whether this strategy sparks a surge in churn, or in other words, will more BT customers switch elsewhere? Many analysts believe the opposite could prove true, reducing churn rather than accelerating it. This is because it's incredibly difficult to change provider for one aspect of a bundled contract, particularly since 'unbundling' it will invalidate any savings. For example, if you're unhappy with the broadband aspect of your quad-play contract, switching to TalkTalk or Virgin, while keeping the rest of your BT services, is likely to be incredibly difficult. This could allow BT to retain customers for longer, even if they are not entirely happy with the complete service.

CONSUMER POWER

That doesn't rule out increased churn entirely, especially when we consider the fairly rotten record on the customer service front of both BT and EE. Both companies are ranked among the lowest for customer service in their respective fields, and are widely derided for their poor handling of issues and complaints. In Ofcom's report earlier this year the watchdog revealed BT's satisfaction rate to be 'significantly lower than average,' also pointing out below average performance on specific customer service measures, including speed and ease of getting through to the right person, time taken to handle issues and offering compensation or a goodwill payment.

The telco has previously admitted that it struggled to cope with the rush of customers following the launch of BT Sport, so it seems fair to assume that absorbing and integrating EE's millions of subscribers may provoke similar criticism.

Other things to bear in mind, the deal is not rubber stamped yet, and it isn't definitely happening. 'We would note that these are provisional findings by the CMA and that a final decision will only be made by 18 January 2016,' explain UBS's analysts. That's eight weeks later than the previous deadline. The chances of the deal falling at the final fence look slim at worst. But what it may do is provoke Ofcom, which is conducting a far-reaching inquiry into the broadband market, to order BT to spin-off its Openreach subsidiary, which runs and maintains the UK nationwide telecoms network backbone. That's what rivals are demanding, and it is among the outcomes feared by BT investors.

SHARES SAYS: ▲▼

We think the EE deal will go through and that it will help propel BT back on to a growth path for the first time in years, and we agree with the bullish consensus.

Restore hits the bullseye

Records management firm seals £60 million deal with Wincanton

WILLIAM CAIN

A £55.7 million deal for long-time acquisition target **Wincanton (WIN)** Records Management means **Restore (RST:AIM)** is now comfortably the second-largest document management business in the UK.

The deal, funded by a £34 million equity raise and new debt facilities, seals Restore's position as a credible rival in the UK to global heavyweight **Iron Mountain (IRM:NYSE)**.

Adding the Wincanton unit looks likely to underpin strong revenue and underlying profit growth out to late 2016. But we remain cautious on the stock because of low growth industry dynamics and a lack of sizeable acquisition opportunities now the Wincanton purchase is complete.

Chief executive officer (CEO) Charles Skinner is a lot more optimistic. 'We've got extraordinary high quality earnings and great growth rates – what's not to like?' he says.

'The records management industry... it's not quite a utility business but it has stable profit streams, good underlying growth and we can grow further through acquisition. That's a hell of a position to be in.'

Acquisitions will be smaller in the future, Skinner admits, but he says the market remains fragmented and Restore's nationwide presence means synergies will now be easier to deliver.

'The advantage is now that we are larger the synergies on other business combinations increase,' Skinner says.

'Now we have UK-wide coverage if an acquisition comes up in some part of the UK we can look at that and work out what those synergies are.

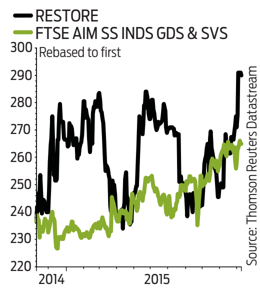
'Three to four years ago, if we bought a business in Leeds and looked at the level of synergies available, they would be much lower than they are today. We could reduce admin and maybe finance costs but in terms of additional synergies they would just not have been there.'

Skinner, who was named earlier this year as a non-exec to Lord Ashcroft-backed **Marlowe (MRL:AIM)** said time commitments at the fledgling investment vehicle were low and his future was firmly as CEO of Restore.

Restore is up 29% including dividends since our bearish call in October 2014.

SHARES SAYS:

At 290p the argument sounds compelling but we remain sceptical of the pay-for-growth model.



Eckoh's patent breakthrough

Locking down key technology is a boost, but shares remain pricey

STEVEN FRAZER

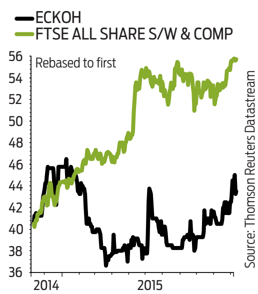
FAST-GROWING VOICE RECOGNITION and secure payments business **Eckoh (ECK:AIM)** has locked down patents behind its *CallGuard* payments technology.

The system works by encrypting the tones transmitted by the phone when someone ringing a call centre enters their payment card number and PIN as they complete a purchase. 'This means that call centre agents cannot access the data, preventing a major source of fraud,' says TechMarketViews analyst Peter Roe.

The US market represents a significant growth opportunity for Eckoh. Organisations are increasingly open to new payment channels to generate business, but are wary of fraud risk. This makes achieving payment card industry data security standard compliance, or PCI DSS as it is typically known, a top priority for organisations. 'We remain excited about the group's prospects in the region,' says Tintin Stormont, analyst at broker N+1 Singer.

SHARES SAYS:

Eckoh has an impressive operating performance but at 43.5p, a March 2017 price to earnings (PE) multiple of 27.2 means the stock is priced for perfection. The price is too high to warrant buying the shares.



Pitching TLA Worldwide

Sell-off creates entry opportunity at small cap media play

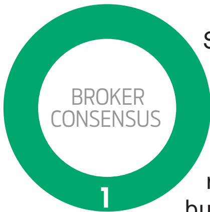
TOM SIEBER

CONSERVATIVE ESTIMATES CREATE scope for earnings upgrades at sports marketing outfit and baseball agent **TLA Worldwide (TLA:AIM)**.

The shares have drifted to 47p since the publication of half-year results (15 Sep) and this has created an opportunity for investors with the stock trading on a 2016 price to earnings ratio based on house broker Numis' forecasts – which it admits are potentially undercooked – of 10 times.

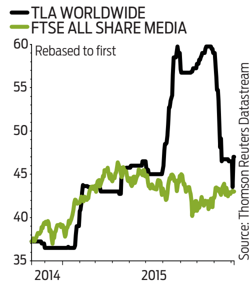
Investors may have to be patient as there are no scheduled announcements until next March when the company's full year numbers should be published. But we believe this patience could be rewarded.

In the first half group revenues advanced 56% to \$15.6 million, with organic growth of 14% bolstered by a first time contribution from Elite Sports Properties (ESP), a UK and Australia-focused athlete and event management outfit acquired for \$19.5 million in March 2015. Baseball revenues rose 11% to \$7.2 million and



Sports more than doubled to \$8.4 million, including ESP.

The baseball representation business is attractive given the enduring appeal of Major League Baseball in the US and the long-term guaranteed income from commission on players' contracts.



In terms of risks – investors should keep an eye on net debt which totalled \$22.4 million as at 30 June 2015. This reflects the acquisition of ESP and the working capital requirements of the newly launched International Champions Cup football tournament.

SHARES SAYS: ▲▼

Numis has a price target of 67p and we are bullish.

SMALL CAP BEST & WORST PERFORMERS*

TOP FIVE

1 WEEK ▲

COMPANY	EPIC	CHANGE (%)
Plethora Solutions	PLE	81.8
Argos Resources	ARG	45.2
Landore Resources	LND	40.9
OptiBiotix	OPTI	37.4
Alecto Energy	ALO	35.0

1 MONTH ▲

COMPANY	EPIC	CHANGE (%)
Mobile Streams	MOS	258.0
Pantheon Resources	PANR	178.0
China New Energy	CNEL	136.0
Sovereign Mines of Africa	SMA	129.0
Pro Global Insurance	PROG	115.0

3 MONTHS ▲

COMPANY	EPIC	CHANGE (%)
Sovereign Mines of Africa	SMA	359.0
Pantheon Resources	PANR	349.0
African Potash	AFPO	266.0
Mobile Streams	MOS	249.0
Pro Global Insurance	PROG	211.0

BOTTOM FIVE

1 WEEK ▼

COMPANY	EPIC	CHANGE (%)
TyraTech	TYRU	-30.3
Highway Capital	HWC	-33.3
Lonmin	LMI	-35.6
Limitless Earth	LME	-41.9
ECR Minerals	ECR	-42.3

1 MONTH ▼

COMPANY	EPIC	CHANGE (%)
LGO Energy	LGO	-48.6
Falkland Oil & Gas	CAZA	-53.6
Lonmin	LMI	-56.7
PeerTV	PTV	-65.7
Sefton Resources	SER	-70.0

3 MONTHS ▼

COMPANY	EPIC	CHANGE (%)
Lansdowne Oil & Gas	LOGP	-75.4
Caza Oil & Gas	CAZA	-75.4
Adgorithms	ADGO	-75.7
Motive TV	MTV	-88.3
PeerTV	PTV	-90.0

*Based on constituents of the FTSE All-Share and FTSE Aim All-Share, £200 million market cap or less
Data taken 09 Nov 2015 market close. Source: ShareScope

Snoozebox's slump

TEMPORARY accommodation provider **Snoozebox (ZZZ:AIM)** expects to post an EBITDA loss of £5 million in 2015 due to the cost of expanding its semi-permanent hotels business. It will launch five additional hotels in the fourth quarter. The £18.8 million cap's shares have fallen by 80% to 8.8p since listing in May 2012. (EP)

LiteBulb switches on

BRANDED PRODUCT developer **LiteBulb (LBB:AIM)** has acquired the rights (2 Nov) to sell a range of wooden toys based on the Peppa Pig franchise, hitting major retailers' shelves from September 2016. At 15p this is a positive development for the £9 million cap, whose new management team is focusing on integration and driving organic growth following a prior flurry of acquisitions. (JC)

Boost for ISG, Styles & Wood

SOLID PERFORMANCE at **Morgan Sindall's (MGNS)** Overbury office fit-out business could be good news for listed peers **ISG (ISG:AIM)** and **Styles & Wood (STY:AIM)**. Activity at Overbury was similar to levels seen in the first half of Morgan's financial year and margins improved, according to a statement on 2 November. (WC)

BROKER RATING: SELL HOLD BUY NOT AVAILABLE

Gear4music turns up the volume

Music retailer eyes swing to profit after double-digit sales growth

EMILY PERRYMAN

MUSICAL INSTRUMENTS RETAILER **Gear4music (G4M:AIM)** is on track to swing to a pre-tax profit in the current financial year following double-digit revenue growth and plans to capitalise on the important Christmas trading period.

The £28.7 million cap's maiden first half results (28 Oct) revealed an impressive 43% rise in revenue in the six months to 31 August. The group's sales are traditionally two-thirds weighted to the second half, when Christmas lands.

Gear4music has launched several new products ahead of the festive period, such as digital drum kits and very lightweight instruments for children.

It has also introduced a UK consumer finance package which it says has had a positive impact on trading. The average order value is £476, four times the group average.

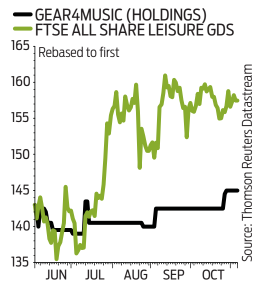
Gear4music made a pre-tax loss of £600,000 in the year ending February 2015 but Panmure Gordon is forecasting a profit of £700,000 for February 2016. We think this is achievable given the strong sales growth, particularly for its own-brand products which are up 25.3% year-on-year.

The company has paid off its loan notes which means it won't have interest charges to pay in the last nine months of the financial year.

Gear4music is expanding in Europe and has seen a 46% rise in visitors to its 18 European country-specific websites.

SHARES SAYS: ▲▼

At 145p Gear4music is a good way to play the £4.3 billion European music equipment market. Panmure Gordon's target price is 180p, implying 24% upside.



Wynnstay worries overdone

Sell-off at agricultural supplies-to-retail group may have bottomed out

JAMES CRUX

WEAKNESS AT WALES-HEADQUARTERED agricultural and retail concern **Wynnstay (WYN:AIM)** looks fully played out. A testing trading backdrop is already discounted, while a recent acquisition extends the £103 million cap's presence into a major new geographic region.

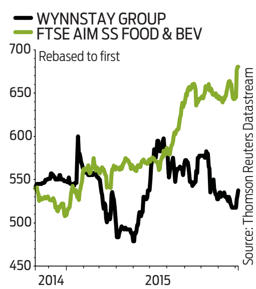
Wynnstay, which supplies agricultural inputs to farmers and operates both country stores and a pet products chain, has seen its shares soften on earnings downgrades. Investors are fretting over short-term headwinds from depressed farmgate prices, particularly milk.

However, *Shares* sticks with its positive view, as Wynnstay offers a play on long-term world food demand and farmers' need for enhanced production efficiencies. A progressive dividend payer with an asset-backed balance sheet, Wynnstay draws strength from a balanced business model and has confidently outlined a new five-year organic and acquisitive growth plan.

Significantly, the purchase (2 Nov) of Agricentre, a West Country farm supplies operation whose products span animal healthcare and nutrition as well as dairy hygiene wares, marks an important strategic development, increasing geographic reach and diversity and bringing scope to cross-sell products and services to Agricentre's customer base.

SHARES SAYS: ▲▼

A drift down to 537.5p is a buying opportunity ahead of an eventual cyclical upturn.



Building value at Laing

Infrastructure specialist's new lease of life as public company

WILLIAM CAIN

Electric-powered trains, highways, bridges – even a sports stadium – it's hard not to be impressed by the pictures of infrastructure projects that surround chief executive Olivier Brousse in **John Laing's (JLG)** West End boardroom.

From this base, Laing's reach spans far and wide and from the mundane to the monumental. From street lights in Croydon to railways in the US or health facilities in Australia, John Laing's civil engineering specialists are on the case.

Public Private Partnerships (PPPs) may not be among the most celebrated of UK exports but they are a system of funding public works projects that are gaining traction with governments across the globe.

In 2013, President Obama delivered a speech from a Miami bridge funded through a PPP and called his plans to revamp the country's economy as 'a partnership to rebuild America'.

REVOLUTIONARY APPROACH

John Laing, with roots in nineteenth century Britain, is an expert in this type of model.

'There would not have been an industrial revolution without PPPs,' says Brousse. 'They were not called PPPs at the time but they were exactly the same.

'When you look around the world today, all the countries using PPPs use the legal and financial framework which was first used in the UK. It's really interesting to see and it's the reason the country became Great Britain in the 19th century – because of these partnerships between the public and private sector.'

Laing operates at the riskier end of the infrastructure industry, known as primary stage investing, a phase which takes projects from concept to completion.

Pension funds and institutional investors are not very interested in the risks associated with building a bridge or motor highway. Once complete, the predictable and long-term cash flows associated with maintaining and operating the assets makes them natural owners of infrastructure assets.

These long-term investors form a secondary market in which primary stage infrastructure funds attempt to onsell their completed projects.

'Today in the world you have a once in a lifetime, maybe once in a century opportunity, whereby you have pension funds or sovereign wealth funds chasing yields with government bonds yielding 2% in some countries, less than 1% in Germany,' says Brousse.

'So if you're a pension fund and you need to invest your money with stable returns over 20 years and governments want to pay 2% then what can you get for 3% or 4%?

'Infrastructure is a good proxy because it is not a government bond but once the asset is built it is more or less a public bond and it runs for 20-25 years.

'So today there is an enormous amount of money that does not go anywhere because there is no yield and inflation.

'What is missing are projects. Projects for 25 years at least on social infrastructure or roads have to be decided by governments. There's a huge opportunity today because governments have needs: population is growing, climates are changing. They know they have to do things.'

Brousse is working hard to make sure these projects come to fruition. As well as meeting the demand of pension funds and long term investors, this should also generate a tidy profit for John Laing in the process.

Returns on equity at John Laing averaged 20% annually over the last seven years, Brousse claims, though he admits similar results will be tougher to achieve in the future.

Competition is stronger and a bolder approach is now required.

GREATER SOPHISTICATION

'If we want to deliver those returns, we have to go for – and we can go for – more sophisticated projects,' says Brousse.

BIOGRAPHY

Olivier Brousse,
chief executive officer

Joining Laing in 2014, Brousse has held leadership roles in a number of companies at least as distinguished as the one he now heads. Prior to taking the top job at Laing, Brousse was chief executive officer at Saur, a France-based public services firm. Brousse also worked for Compagnie Générale des Eaux, founded by Napoleon Bonaparte's son and predecessor to three of France's best known businesses: construction outfit **Vinci (DG:EPA)**, waste management firm **Veolia (VIE:EPA)** and media giant **Vivendi (VIV:EPA)**.

'Those kinds of returns on a simple school PPP... I think today they would be unachievable because the risk is not that great. Everyone knows how to deliver schools now whereas in the 1990s it was probably different.

'Now if you look at John Laing we are working on more innovative projects like the Intercity Express Programme, the train fleet for the Eastern and Great Western lines. We're going for process plants like the Greater Manchester waste-to-energy plant. This is where the transfer of risk and the sophistication of the projects justify the margins.'

As well as project diversification, Brousse is working on building Laing's geographical reach. Following on from President Obama's infrastructure pledges, Brousse says there is a growing opportunity in the US.

Discussions with some of the leading US construction firms have been positive and Brousse says they are keen on working with Laing on PPPs in the country.

The model used in the US is 'almost exactly the same as the one used in the UK'.

'If you are a governor of a state in the US and you are staking part of your reputation on the success of a PPP project, you had better take people who are competent,' says Brousse.

Infrastructure is 'complex' Brousse admits. It requires high quality people on both sides – the private sector and the public sector – to design projects that work. Building and operating assets is not straightforward and nor is financing the projects and marketing them for sale on completion.

More complex projects are needed to make decent returns.

This complexity within infrastructure is something that has put us off John Laing in the past despite the clear of appeal of infrastructure assets themselves. Perhaps hardest to understand for ordinary investors is Laing's financial structure.

The business was recently sold by asset manager **Henderson (HGG)** on to the stock exchange via an initial public offering (IPO). And understanding the assets on Laing's balance sheet is not easy.

Valuations of all of its investments are calculated by estimates which we understand are fairly rigorous. They must be approved by the company, lawyers, accountants and so on, meaning they will be a reasonable estimate of the current market value of the roughly 40 projects it operates.

But they are only estimates, known as Level 3 fair value measurements in accounting speak. They are 'derived from valuation techniques that include inputs to the asset or liability that are not based on observable market data'.

Brousse says this should not be too much of a concern for prospective investors, arguing the valuations are conservative. During the initial public offering process, the argument was made to *Shares* that Laing's asset valuations were more conservative than its already–listed peers, though this may simply be because its projects are higher risk.

Within the individual projects, as in all infrastructure and private equity funds, there is a large amount of debt which is not shown on Laing's balance sheet.

But the project investment vehicles are non-recourse units meaning if they fail Laing loses only its investment and is not liable for the debt within the vehicles, Brousse says.

INVESTMENT CASE

John Laing

(JLG) 191p ▲

SUMMARY

Exiting the construction business after a financially disastrous involvement in Cardiff's Millennium Stadium project, John Laing is now squarely focused on the project management of early stage infrastructure projects (primary markets). This means building consortia of construction and support services contractors, raising finance and bidding for infrastructure contracts. Once the projects are complete and operational, Laing seeks to onsell its stake to pension funds or other investors (in secondary markets).

BULL CASE

- Active secondary market
- Project wins at acceptable margins
- Solid track record

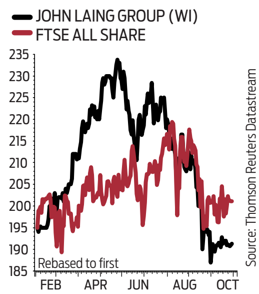
BEAR CASE

- Secondary market dries up
- Reduced availability of bank credit
- Riskier projects backfire

Market value:
£702 million

Prospective book value per share Dec 2015:
232p

Prospective dividend yield:
4.7%



THE REVIVAL OF 'OLD MEDIA'

We look at the beneficiaries as physical books and live TV demonstrate stickability

TOM SIEBER

We live in a digital world. An increasing amount of our entertainment, learning and social interaction takes place electronically, often over the internet. But the demise of traditional formats like watching live TV through a television set and sitting down to read physical books may have been exaggerated.

Waterstones boss James Daunt announced in October that, thanks to 'pitiful' sales, **Amazon's (AMZN:NDQ)** Kindle e-reader was being removed from shelves to make space for printed books. The Association of American Publishers reported e-book sales down 10% in the first five months of 2015.

In a surprise move, Amazon is now opening its first physical bookstore; a shop in Seattle stocked with 5,000 books. Support services group **Connect (CNCT)** has a books distributions business and in October reported a recovery in demand from independent book shops and improving sales through online and multi-format retailers.

Britons watched just as many hours of live TV in 2014 as they did 10 years earlier, according to figures from the Broadcasters' Audience Research Board. We think both free to air broadcaster **ITV (ITV)** and illustrated non-fiction publisher **Quarto (QRT)** could be beneficiaries as the market picks up on the enduring appeal of their respective formats.

PLAY THE MUSIC

In some respects the revival of the physical book mirrors renewed appetite for vinyl albums. Sales of records topped one million in 2014 for the first time since the 1990s as consumers warmed to their aesthetic appeal.

We're not suggesting print is the next big growth area. The UK bought 237 million books in 2008 and by 2013 this had fallen to 184 million, amounting to a 22% fall according to figures from Nielsen Bookscan. However there are signs the decline is being arrested. In 2014, 181 million books were bought which represents an annual decline of just 1.7%.

'The printed book never went away,' says Quarto chief executive Marcus Leaver. 'People have continued to sell and make books throughout the period when their demise was being widely predicted.'

Leaver believes a combination of the financial crisis hitting sales and the allure of all new technologies led to the predictions that the e-book would subsume physical books entirely.

'A lot of our books are coffee table or as I'd prefer to call them "gift impulse books" and these do not translate well on to today's e-readers or the apps available on tablets. My books work very well in paper.'

FUND MANAGER APPROACH

Two thirds of Quarto's revenues come from its 'back-list' of previously published books. Leaver describes his role in running this portfolio of titles as being like a fund manager. 'When I started I realised we were under-represented in children's books and from $14.7 million worth of revenue our children's arm will generate in the region of $31 million in 2015.'

Speaking from the Sharjah International Book Fair in the United Arab Emirates, Leaver says further growth opportunities lie in an extension of the children's arm and by opening up new markets such as the Middle East.

The company continues to pay down its net debt of $80 million. Its store of intellectual property and a publishing platform that enables it to bring content to a number of different markets rapidly is not reflected in a share price rating of 4.0 times Northland Capital's forecast earnings per share of 55.2p.

A third quarter update (4 Nov) revealed full year numbers would be in-line with expectations. Shore Capital commenting: 'Amongst the group's key attractions we would particularly highlight its experience and growing authority within the foreign language and children's publishing markets, and the significance of its consistently strong back–list performance/co-edition publishing expertise in reducing risk, driving revenue visibility and generating cash.

'Importantly, we also note that the advent of digital delivery has not damaged the group's print business (reflecting the long-lasting content-rich

nature of its books/focus on niche genres) and sense a growing perception within the publishing / retail sector that the demise of the printed book segment may has been overstated.'

Quarto is not the only publisher benefiting from print's resilience. Among the releases which could be big sellers for **Bloomsbury (BMY)** are the illustrated versions of the *Harry Potter* books, with the first title released in October 2015.

Bloomsbury executive director Richard Charkin, formerly the chief executive of Macmillan Publishers, says print has a 'terrific viable future' although he says the claims of the death of the e-book are also overdone. Adding that there is a significant opportunity for Bloomsbury to tap into its back-list and publish these as e-books, he notes *Kitchen Confidential*, a behind-the-scenes look at the New York restaurant scene first published in 2000, was among its e-book bestsellers in 2014.

ON DEMAND

The shift online has been more pronounced in newspaper than book publishing where the likes of **Trinity Mirror (TNI)** and **Johnston Press (JPR)** are struggling to replace lost print advertising revenues by somehow monetising their online content.

There could even be a new threat. When we sat down with the chief executive of Scottish free-to-air broadcaster **STV (STVG)** in late 2014 he explained that the new city channels for Glasgow and Edinburgh were partly an attempt to grab a share of the low-cost advertising currently dominated by local newspapers.

In broadcasting the digital revolution has been reflected in the development of so-called time shifted viewing through video-on-demand services streamed over the internet. The most obvious examples being the likes of **Netflix (NFLX:NDQ)** and Amazon Instant Video.

Yet in a piece of research earlier this year Liberum's media team argued that the so-called 'media elite' were significantly underestimating the amount of time people spent watching live TV and how often this was through a television set. These conclusions are reflected in the accompanying charts.

GETTING NOTICED

TV remains a very effective means of advertisers getting their message across to consumers. It is more transparent than online advertising where there are growing fears that advertisers are essentially being defrauded – a topic we recently debated (see *Shares, Talking Point*, 22 Oct 2015).

> 'The printed book never went away'

Speaking at a Liberum event in September Simon Terrington, chairman of media consultancy Terrington & Co, says: 'TV viewing has held up well in the last ten years, probably much better than we expected it to. Fundamentally (online) is a different market to the likes of ITV uniting the population for which they get a premium, that is likely to go on for at least the next three or four years, after that it starts to get more complicated.'

This relative stasis is good news for ITV, although obviously there are risks further out which investors should note and on which we will keep a close eye.

Another piece of good news could be the introduction of retransmission fees. In summary, this would involve cable and satellite providers like **Sky (SKY)** and Virgin Media paying their free-to-air counterparts for the right to broadcast their channels.

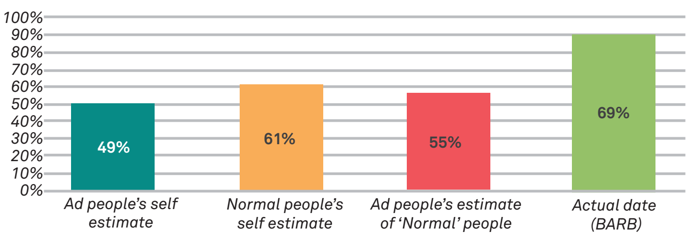
Retransmission fees are standard industry practice in the US and, because there is no extra cost involved, these revenues are essentially 100% profit margin. Even a modest amount of revenue can therefore have a significant impact on the bottom line.

Terrington adds: 'I believe platforms will start to pay retransmission fees. Power is shifting from the platforms to the channels.'

ITV reaffirmed its commitment to TV as it acquired the television assets of fellow broadcaster and the Channel 3 operator for Northern Ireland **UTV (UTV)** for £100 million. In its third quarter results (10 Nov) ITV posted a 13% advance in revenues for the first nine months of 2015 to just more than £2 billion and flagged an 'encouraging' outlook for 2016.

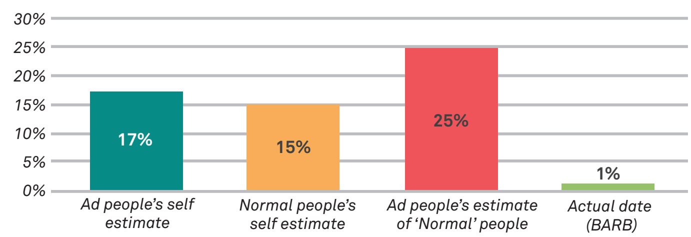
Some fizz is added to the ITV investment case thanks to speculation linking Virgin Media owner and 9.9% shareholder **Liberty Global (LBTYA:NDQ)** with a bid.

Estimated proportion of TV viewing that is live



Source: TV nation: 2013 Ipsos Media CT/Thinkbox. Question: Of the time you/the public spend(s) watching television (excluding DVDs and programmes you recorded more than a week before), what proportion of that time is spent watching live?

Estimated time spent watching TV on other devices



Source: TV nation: 2013 Ipsos Media CT/Thinkbox. Question: Of the time you spend watching TV programmes or films (not including DVDs) what proportion of that time is spent watching TV on your TV, PC/Laptop, tablet, phone. Data shown for other devices (not TV).

C&C lacks fizz

Poor organic performance and long risk-list are reasons to avoid Magners maker

JAMES CRUX

SHARES EXPLAINS • SHARES EXPLAINS •
What does this company do?

Beverages giants **Diageo (DGE)** and **SABMiller (SAB)** boast strong recognition among London's investment community, while overseas-listed names such as **Heineken (HEIN:AS)** and **Carlsberg (CARLB:CO)** are widely known by the layman due to their eponymous brands.

Yet one less well-understood alcoholic beverages business with a strong stable of brands is **C&C (CCR)**. This is rather curious, since most of us will have consumed the Dublin-headquartered company's products, either on a raucous night out or to quench a thirst whilst soaking up the rays in a balmy pub beer garden.

Though C&C is highly cash-generative and rising consumer confidence and disposable income could boost performance, we are worried by the numerous headwinds it faces and we don't see too many catalysts for a near-term re-rating.

C&C IN FOCUS

C&C is the manufacturer, marketer and distributor of a range of branded cider, beer, wine and soft drinks, but predominantly, it makes branded long alcoholic ciders. It is responsible for leading Irish cider brand Bulmers, as well as premium international cider brand Magners and the C&C Brands range of English ciders and Tennent's beer. The beverages company also distributes a number of beer brands in Scotland, Ireland and Northern Ireland for Budweiser brewer **AB InBev (BUD:NYSE)**.

In addition, C&C owns and manufactures Woodchuck and Hornsby's, two of the leading craft cider brands in the US. And on top of all this, C&C's Irish wholesaling arm Gleeson owns and makes Tipperary Water and Finches soft drinks, and the company also owns Scottish drinks wholesaler Wallaces Express.

SOGGY OUTLOOK

Brand strength is undoubtedly a key competitive advantage of C&C's, yet disappointingly, the company has not been able to report positive group organic growth since 2007. And this is despite operating primarily in the growing cider category.

Investors will therefore need to see a significant turnaround in C&C's performance if the shares are to rebound from current depressed levels. Little wonder that US activist investor Orange Capital reportedly wants C&C to sell off its struggling US business, consider a sale of its business in England and Wales and focus on its core markets of Ireland and Scotland.

Forecast downgrades followed interim results (28 Oct), revealing 2.6% top-line decline to €358.6 million (£255.2 million) and a 9.5% drop in operating profit to €62.6 million, caused by tough trading in core markets Ireland and Scotland and a sub-par performance across the pond.

CEO Stephen Glancey was at pains to point out many of the factors behind the dour performance were 'one-off or transitional'. These included poor weather, which crimped Bulmers volumes, the transition to a brand–led wholesale model, the impact on beer volumes in Scotland from tighter drink-driving legislation, not to mention increased competition from new entrants in the cider and craft categories.

Indeed, in the important Irish market, the competitive landscape is toughening for C&C. In the off-trade, Heineken's Orchard Thieves brand is thought to be gaining traction, while in the on-trade, craft ciders are continuing to take 'tap handles' from C&C. Worryingly, the US business witnessed a 12.5% sales decline in a market growing at over 30%.

Glancey warned these aggregated headwinds will cause a €10 million profit hit in the current financial year, though the positive news is C&C is now targeting a further €15 million of annualised cost savings, which it can reinvest in marketing spend, and also reaffirmed a net debt/EBITDA target of two times.

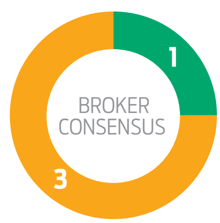
One avenue of considerable opportunity for C&C is exports, where capital light expansion through distribution and licence agreements is management's preferred model – and thanks to its well-invested domestic asset base, C&C is driving volume growth with minimal extra cost. During the first half, export operating profits frothed up by 31% to €2.1 million, fuelled by the Magners, Tennent's and Shepton brands.

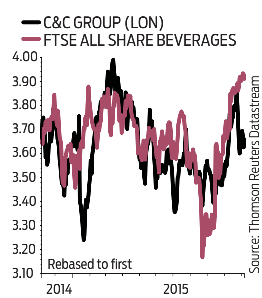
Glancey sees cider as an international growth

C&C IN NUMBERS

(€m)	FY16E	FY17E	FY18E
Sales	689.7	675.8	695.1
Pre-tax profit before exceptionals	98.6	95.9	100.9
Earnings per share before exceptionals	25.8	26.7	30.6
Dividend per share (€)	0.1	0.1	0.1

Source: Berenberg





driver across Africa, Asia Pacific and Europe and new distribution arrangements have been put in place for Poland, South Korea and Nigeria 'with further countries to follow in the second half.'

CORPORATE POSSIBILITIES

Although it is struggling to generate high-quality organic growth, C&C is copiously cash generative, having reported 115.6% growth in free cash flow to €66.4 million in H1. This cash flow, allied to a strong balance sheet, gives it the flexibility to pursue corporate opportunities, albeit acquired growth is a riskier way of boosting the top line performance, as well as to invest in competitive advantage and fund capital returns. Having upped the half-time payout 5.1% to 4.73 cents, C&C also plans to re-initiate share buy backs and return up to €100 million to shareholders by July 2016.

Against a backdrop of further consolidation in the brewing sector, C&C has been linked with a number of intriguing transactions. The Irish drinks company is thought to be running the rule over acquiring assets likely to be sold once the mega-merger of AB InBev and SABMiller goes through. C&C mainly focuses on ciders, but is thought to be weighing a tilt at the Bass and Boddington's beer brands, both owned by AB InBev and which could fetch circa £30 million apiece.

Over the summer C&C, keen to expand outside Ireland and Scotland and bulk up its portfolio in England and Wales, is thought to have held talks with Carlsberg about a deal to buy the Danish brewer's UK business. Last year, C&C was even rebuffed by taverns operator Spirit Pub, which eventually agreed to be acquired by larger rival **Greene King (GNK)** in a £774 million deal. C&C was interested in Spirit as a way of matching its route-to-market strength in Ireland and Scotland over in England and Wales through the management of Spirit's high-quality pub estate, though the potentially audacious strategic shift from C&C unnerved investors at the time.

RISKS REMAIN

Berenberg is less than enthused by the C&C investment case, with a 'hold' rating and €3.50 price target. Its downgraded forecasts for the year to next February point to sluggish top-line progress to €690 million (2015: €684 million) for earnings of 25.8 cents, with sales then set to sag to €676 million for earnings of 26.7 cents by February 2017. Based on this year's forecast dividend of 12 cents, C&C does at least offer a 3.25% yield.

Risks to earnings include the perennial threat of unseasonably cold weather, a frequent occurrence given its core markets are Ireland and Scotland. In addition, there's increased competition from rival brewers entering the cider category as they seek to capture the opportunity of female non-beer drinkers. Rising excise duties is another worry; in fact, Berenberg flags the potential risk from 'equalisation of cider excise duty with that of beer in the UK, Ireland and/or the US', which could 'materially affect the growth of the category in these markets.' And last but not least, given C&C's lack of organic progress, there is the chance it could overpay for an acquisition, squandering shareholder value in the process.

SHARES SAYS: ▲▼

At €3.69, we think C&C is one to avoid near-term given the risk of further downgrades. Organic growth has disappointed for some time in Ireland and Scotland and scope for value destructive M&A makes us nervous.

Social trading

Copying the moves of 'experienced' traders is taking off – but the risks are substantial

EMILY PERRYMAN

In our weekly Money Matters section we explore the tools and tricks of the trade to help you make the most of your investments. Whether you're new to investing and don't know where to start or have a gripe about a particular product or service, please email us at **editorial@sharesmagazine.co.uk** and we'll investigate.

The proliferation of **Twitter (TWTR:NYSE)** means most of us are used to following strangers and copying their fashion, eating habits, music or literature tastes. Mimicking these same people's financial trades sounds like a step too far but it's something many wannabe traders have started to embrace, despite the enormous risks involved.

Over the last three years numerous 'social trading' platforms have been launched and they've been luring customers in with eye-catching headline figures and the opportunity to become the next Gordon Gecko without lifting a finger.

In an era of low inflation and disappointing stock market returns it's no surprise that investors are looking for alternative ways to grow their income. Social trading platforms, with their photos of happy smiley people, community feel and cool buzz words, are an attractive choice.

We'd advise readers to be extremely cautious. The headline figures can be very misleading, the way the top traders are picked is often ambiguous and there's a high chance you could suffer a crippling loss.

WHAT IS SOCIAL TRADING?

Social trading platforms let novice traders automatically copy the trades of more experienced traders. If a trader who you're copying bets on the pound rising against the dollar then so will you. You don't need any in-depth knowledge about financial markets but simply have to choose the traders who you think look most profitable.

The platforms have a community feel because they let successful traders share their experiences with others and allow new traders to share comments on the performance of the live traders.

The most well-known and biggest social trading platform is Etoro, with more than 5 million members. Once you've signed up and funded your account you use Etoro's OpenBook People page to find and filter the top traders, who are called 'popular investors'. You can look at the traders' profiles, portfolios, trading stats and the number of copiers. Once you've found the traders who you like the best you click 'copy' to start automatically copying their positions.

RISKS

Lots of social trading platforms state there is an 80% success rate for copied trades, but this can be very misleading. The statement merely means that out of 100 trades 80 were successful while 20 incurred a loss – it doesn't give you any indication of what those profits or losses were. It's very possible that the loss could be greater than the realised profit.

To give an example cited by Digital Derivatives Markets, on 80 trades the profit could be £2,000 but the total loss from the remaining 20 trades could be £5,000. Even if an 80% success rate is achieved you could still incur a net loss of £3,000.

MITIGATING RISKS

Some social trading platforms have features to help you to mitigate these risks. Etoro limits the amount you can allocate per trader to 40%, which forces you to spread your risk. You can copy up to 20 different traders at any given time.

Most platforms reward their top traders on the number of followers they have and/or the profits they make, but Ayondo also looks at their

Social trading platforms

Some of the key providers include:

- Etoro
- Ayondo
- Signal Trader
- GetStocks
- ZuluTrade
- Orbex
- Copyop
- FxPro SuperTrader
- Tradeo

risk management approach. If the trader takes more risk during a month their commission will be reduced. Ayondo also manages your allocation proportionally to the trader's account, so if they risk 5% only 5% of your balance will be at risk.

On ZuluTrade the risk you take is entirely up to you and one trader or even one trade could wipe out your entire investment. You can limit this risk by changing your settings to limit losses on the account or per trader.

There is also a ZuluGuard feature which monitors each trader's behaviour and automatically takes action when a radical change in their trading strategy is detected. You can choose from three protection schemes and ZuluGuard will take the actions you have specified, for example closing all the trader's trades or replacing the trader with an equal or better ranked trader.

WHO ARE THE TOP TRADERS?

One of the biggest issues with social trading platforms is you're putting your faith in someone who you've never met.

When you invest in traditional funds, you can be sure the fund manager has sat the relevant financial exams, they're regulated and they have many years of experience.

Most social trading platforms have no such requirements – anyone can become a top trader and they're ranked on their performance results which at ZuluTrade can be based on a minimum trading time of just 12 weeks. Profitable trading could be purely down to luck rather than skill.

Ayondo has stricter requirements. Traders have to pass through five levels – street trader, advanced, professional, risk-adjusted and institutional – and be trading for one year before they can become a top trader. If they lose more than 25% they're relegated to street trader level and they can't become a top trader ever again.

Peg Reed, senior vice president at Ayondo, says it would be very tough for someone without any trading experience to work their way up to the institutional level. They would need a robust trading algorithm and be good at coding.

'Not just anyone on the street can become a top trader. It takes time and patience – you need to know what you're doing. Our criteria are very stringent,' she says.

To qualify for Etoro's 'popular investor' programme traders must have an account linked to Facebook, LinkedIn or Twitter, a completed profile, at least three months' trading history, a risk profile of eight or under and a minimum of 10 copiers.

'As new users are constantly joining Etoro, we wanted to allow a grace period of trading before a member can be eligible to apply to become a popular investor. This encourages commitment and consistency on the part of the trader, to encourage more responsible trading thus reducing some of the risk to their potential copiers. These safeguards are in place to ensure that potential and existing copiers know that they are copying a real person, not a robot, and that users who have been accepted to our popular investor programme have undergone a rigorous verification process,' says Yoni Assia, chief executive and co-founder of Etoro.

Etoro's 'Elite' popular investors can earn 2% of their annual assets under management (AUM), paid monthly, or a minimum of $1,000 in revenue, whichever is higher. If they have an average AUM of $1 million in a month they will earn $1,666. They earn a rebate from the net spreads paid during the previous month and the payment level is determined by the average number of daily verified copiers and the minimum account equity.

Questions to ask a social trading platform

- How and where it is regulated?
- Can you lose more money than you put in?
- How are the top traders selected?
- What risk management tools are provided?
- Can you trade in sterling or is your money converted to US dollars?
- What is the minimum investment?
- What is the typical spread?

SKEWING THE DATA

Even if a trader has a relatively long trading history it's possible to skew the data. According to SocialTradingGuru.com, traders can make their win/loss rate appear better than it actually is. For example some might keep their losing trades open to avoid posting losses and in the hope the trades will bounce back.

You can usually click on the top trader to find out their background – for example how long they've been trading and where they learnt to trade – but Signal Trader doesn't provide this information. Jonathan Hirshberg, vice president of operations at Signal Trader, says his firm provides automated trading as opposed to social trading.

'It's not a portal where people can chat, but is high net worth individuals who are interested in participating in trading but want someone else to do it for them,' he explains.

Signal Trader only displays 15 trading systems for customers to choose to copy and the individuals or firms behind the systems are completely anonymous. 'An individual shouldn't care who the firm or trader is because all the information is laid out by their trading history,' says Hirshberg.

'We try to generate a basket of providers and by following them clients can carry on with life and don't need to think about trading. We're trying to bring the 99% of customers to the 1% of traders who maintain a profitable portfolio,' he adds.

COSTS

Social trading platforms don't have an initial joining fee or charge you for following their top traders but this doesn't mean they're free. They make their money by having wider spreads – the gap between the buy and sell price – than traditional spread-betting firms like **IG (IGG)** or City Index. These spreads vary from one platform to another and they can widen beyond the figures displayed due to market conditions.

The benefits of share buybacks

As the first European buyback tracker launches we look at this space in more detail

TOM SIEBER

Nearly nine out of 10 investors (87%) are looking to put their money in assets to generate income, according to a Schroders study published in May 2015. Most people look for dividends as a way of collecting a regular stream of cash from a listed company or fund in the future, but there are other ways by which investors can benefit from cash returns.

Share buybacks are often employed by companies as a means of returning cash to their shareholders. They aren't physically putting cash in your pocket, but they are using cash to reduce the number of shares in issue.

The percentage of the company you own is boosted when a company buys back its own shares and cancels them. In theory this means the pot of cash to pay dividends in the future is shared by a smaller pool of people, so each investor should get more money.

French asset manager Amundi has launched the first exchange-traded fund (ETF) to track European firms pursuing share buybacks. The product aims to capture the performance of constituents of the MSCI Europe index which have performed buybacks in the past 12 months.

Although it currently trades in Paris and is not listed in London yet, its launch is a good spur to look at the existing buyback ETFs on the London Stock Exchange. These either target either a global basket of stocks or the US market. The list includes **iShares US Equity Buyback Achievers (BACK)**, **Powershares Global Buyback Achievers (SBUY)** and **Amundi S&P 500 Buyback (BYBG)**.

All three accumulate rather than distribute any income and reinvest it back into the respective fund. The products are therefore not suitable to investors who need that regular stream of cash, such as those in retirement. Instead, it may be attractive to investors who can afford to do without income for the time being and want to benefit from the power of compound interest and dividend reinvestment to accelerate the potential gains.

CASH-RICH

Amundi says: 'Share buyback programs allow cash-rich companies to repurchase their own stocks. Already widely used in the US, they should become more popular for European companies as they represent a more efficient use of cash in a low rate environment and give companies more flexibility than dividend programs. Moreover, buyback programs are

compelling for investors as they can provide higher returns in a low rate environment.'

Shares has some issues with buybacks particularly in cases where they are being used to inflate earnings per share (EPS). By reducing the number of shares in issue through purchasing them, a firm can increase the earnings *per share* without actually seeing any improvement in operational performance. Investors should be particularly cautious when management are incentivised by EPS targets, often being the trigger for bonus payments.

Putting these potential objections to buybacks to one side it is worth noting that the MSCI Europe Equal Weighted Buyback Yield Index, which the new Amundi fund tracks, has outperformed its parent MSCI Europe in 13 of the last 14 years.

Arguably companies which are repurchasing shares enjoy the following attributes:

- They're profitable and cash generative (assuming they're not using debt to fund buybacks).
- They are prepared to return capital to shareholders.
- They believe their shares are undervalued.

Buybacks are also potentially more tax efficient for investors than dividends. Capital gains tax is lower than income tax.

GLOWING EXAMPLE

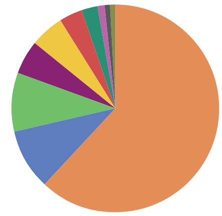
High street retailer **Next (NXT)** shows how it can be done effectively. Its priority is to run an efficient balance sheet, unencumbered by excess cash generating negligible returns on deposit, but it will not buy back stock irrespective of price or valuation. Instead, depending on the share price the company may opt to buy back shares, increase the ordinary dividend or pay a special dividend.

The commentary in this year's interim results spells it out. 'This year, as our shares have consistently traded above our buyback price limit, we have not bought back any shares but have instead returned surplus capital to shareholders by way of special dividends. We have paid three special dividends so far this year, a 50p dividend was paid in February, 60p dividends were paid in May and August and we have announced a further special dividend of 60p which will be paid in November.'

POWERSHARES GLOBAL BUYBACK ACHIEVERS (SBUY) £17.80

Total expense ratio: 0.39%
Method of replication: Physical

BASED ON THE NASDAQ Global Buyback Achievers Index this product seeks to replicate the performance of international shares issued by companies which have effected a net reduction in shares outstanding of 5% or more. Among the top 10 holdings are leading Japanese mobile phone operator **NTT DoCoMo (9437:TYO)**, US tech giant **Apple (AAPL:NDQ)** and French cosmetics business **L'Oreal (OR:EPA)**.



Country allocations

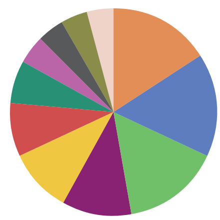
US	60.0%
Japan	9.3%
Canada	8.8%
Germany	5.17%
France	4.9%
UK	3.6%
Netherlands	2.4%
China	1.0%
Belgium	0.8%
Switzerland	0.8%

Source: Powershares, as at 5 Nov 2015

ISHARES US EQUITY BUYBACK ACHIEVERS (BACS) 333.5P

Total expense ratio: 0.55%
Method of replication: Physical

THE BENCHMARK INDEX is NASDAQ US Buyback Achievers Select Index – which encompasses stocks which have effected a net reduction in shares outstanding of 5% or more in the previous 12 months – and there is a significant bias towards technology. The top holding at 2.4% is video conferencing specialist **Polycom (PLCM:NDQ)**.



Sector breakdown

Technology	16.0%
Other	16.0%
Industrial Goods & Services	15.3%
Retail	10.9%
Insurance	10.2%
Personal & Household Goods	8.3%
Media	6.6%
Chemicals	4.4%
Travel & Leisure	4.2%
Oil & Gas	4.1%
Financial Services	4.1%

Source: iShares, as at 4 Nov 2015

AMUNDI S&P 500 BUYBACK (BYBG) £78.05

Total expense ratio: 0.15%
Method of replication: Synthetic

THIS TRACKS THE S&P 500 Buyback index which includes the top 100 stocks from the S&P 500 index with the highest buyback ratio over the past 12 months. All index constituents are then weighted equally.

TOP 10 CONSTITUENTS BY WEIGHTING

1.	SanDisk	(SNDK:NDQ)
2.	Southwest Airlines	(LUV:NYSE)
3.	Starwood Hotel & Resort World	(HOT:NYSE)
4.	L-3 Communications	(LLL:NYSE)
5.	Navient Corp	(NAVI:NDQ)
6.	Sherwin-Williams	(SHW:NYSE)
7.	Travelers Companies	(TRV:NYSE)
8.	Yahoo	(YHOO:NDQ)
9.	Avery Dennison	(AVY:NYSE)
10.	American Airlines	(AAL:NDQ)

Source: S&P, as at 30 Oct 2015

FALLOUT FROM SHATTERED DEFENCE SECTOR

AS WARNINGS ABOUND WE TAKE A LOOK AT THE WINNERS AND LOSERS

SEAN FLYNN

A wave of profit warnings is shaking the foundations of the aerospace and defence sector. Picking through the wreckage we remain positive on running *Play of the Week* **Senior (SNR)** at 234.7p but lose our previous faith in turnarounds at **Meggitt (MGGT)** and **Chemring (CHG)** and are also negative on **Cobham (COB)**. All three have warned about trading issues since the middle of October.

A mixture of wider weakness in the industrials sector thanks to global economic jitters, a reversal in the previous buoyant civil aerospace market and poor execution have contributed to a series of downbeat statements.

Nevertheless this is a diverse space with differing inputs and end-markets so it is difficult to draw broad-based conclusions. Instead investors need to look at each story on a case-by-case basis. As evidence of this, while companies like Chemring, Senior and Meggitt have all shown year-to-date declines in excess of 20%, small cap niche operators such as **Cohort (CHRT:AIM)** and **Avon Rubber (AVON)** have both seen share prices advances in excess of 50%.

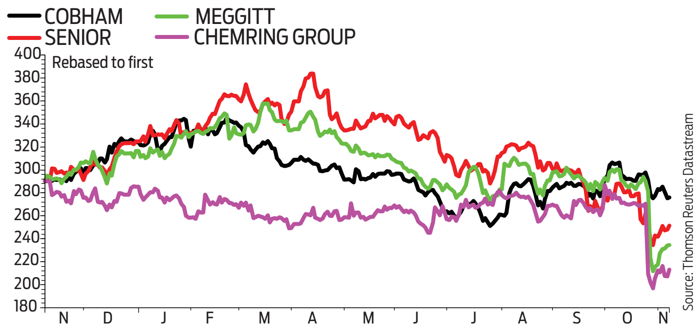
BLOW OUT

Let's look first at Chemring where shares are down more than a quarter so far in 2015 to 178.5p. A 26 October update revealed delays to the group's Middle East contract for 40mm ammunition – which Chemring had proudly announced on 14 September – meant that the deal was not after all going to add to the bottom line for full year 2015.

You could argue that the market has overreacted to a timing issue in a sector where revenues can be notoriously lumpy. However, Chemring's issues are long standing. A specialist in countermeasures and munitions the company has been hit with a series of profit warnings since 2012 as it contends with a general slowdown in defence spending which was accentuated by the withdrawal of troops from Iraq and Afghanistan where many of its products were used.

Panmure Gordon analyst Sanjay Jha is a seller of the stock. While he acknowledges the judiciousness of the group's decision to shore up its rather indebted balance sheet with a £90 million rights issue, he worries that this, coupled with the hit to sentiment from the hold-up in the Middle Eastern contract, puts heavy demands on the valuation. At 18 times his 2016 earnings per share (EPS) forecast, Jha notes that the stock is trading well above UK peers at 12-15 times.

Senior on the other



hand might have stronger recuperative powers. There are reasons to believe that the £941.2 million cap can respond to the difficult environment that it and its peers are presently experiencing. Citing 'its programme positions, operational flexibility, good and consistent cash generation and robust balance sheet' Investec's Thomas Rands' view that the stock is undervalued looks about right to us. At 11.8 times 2016 consensus EPS the stock is at a small discount to the wider sector.

POWERS OF RECOVERY

On 27 July, Senior delivered a solid set of results in the first half of 2015. Revenue and adjusted profits increased while free cash flow remained relatively healthy despite a less than helpful backdrop.

Although Senior has not yet updated the market in the interim, earnings forecasts have been downgraded, Investec has reduced full year 2015 and 2016 forecasts by 6% and 9% respectively. This is largely a result of the headwinds being faced by the flexonics division – serving the automotive and energy divisions – rather than the aerospace arm.

Flexonics consists of 14 operations, four which are located in North America; three are in continental Europe, two in the United Kingdom with the other operations based in South Africa, India, Brazil, Malaysia and China. It manufactures gas re-circulation tubes, precision-machined compontents for the oil and gas industry and carbon steel water tubes among countless other products. We expect a trading statement on 19 November to clarify the impact of falling demand in some of the company's key markets.

BUCKING THE TREND

IT HASN'T BEEN all bad news in this sector; Avon Rubber – which has risen 52.5% on the year-to-date – remains a *Play of the Week* (see *Shares*, 13 Aug). Boasting a business mix that manages to be both bellicose and bucolic, Avon Rubber designs and manufactures respiratory protection systems for defence, fire, and industrial markets as well as offering polymer-based products for the dairy and defence industries.

It benefits from recurring revenues associated with the consumable filters used in its respiratory equipment and has also branched out into homeland security, fire fighting and law enforcement. Cohort, which has built through acquisition a portfolio of businesses in niches such as submarine communications, has also been a very successful *Play* (*Shares*, 29 Jan). The group has a building order book, is highly cash generative and as at 31 August still had £12.4 million cash on its balance sheet.

Aircraft engineer Meggitt's 28 October update didn't have much to offer in the way of good news; looking back or forward. In what amounted to a profit warning, the company said that underlying operating profit for 2015 was expected to be 'meaningfully' below company-compiled consensus at £369 million. This was blamed on poor third quarter trading, acutely highlighted by 'marked deterioration' in September.

WIDESPREAD SLOWDOWN

This weakness is being reflected in a slowdown across many of Meggitt's end markets including the civil aftermarket and the military and energy businesses. These headwinds are expected to persist in the final quarter so it appears the pain is far from over. Analyst Tina Cook at Charles Stanley maintains that this poor third quarter has been interpreted to mean a shortfall in anticipated earnings of around 10%.

If that wasn't reason enough to steer clear of Meggitt at 384.2p, we recently highlighted new research from Liberum (see *Shares, Agenda* 5 Nov) which has a list of stocks facing 'mountains' in the second half of 2015. It defines this as being firms with second half earnings per share weightings that are 5% or more than their median over the past five years. Bournemouth-based Meggitt was one such company, as was sector bellwether **Rolls-Royce (RR.)**.

MORE DISAPPOINTMENT

Another disppointing performer this year has been Cobham at 276p. The £3.2 billion cap, which is engaged in the development, delivery and support of aerospace and defence systems in the air, on land and at sea, posted a rather downbeat update on 5 November when it told investors that full year earnings per share in 2015 were likely to be at the lower end of market expectations.

It now seems that Cobham will not deliver on its own mid-single digit organic revenue guidance for 2015, largely thanks to its exposure to the commodities sector. The cold truth is that Cobham may struggle to demonstrate organic revenue growth going forward despite significant investment in recent years. Cobham may have further to fall and should be avoided as weakness in a number of its commercial markets may yet offset any recovery in defence budgets.

Globo investors prepare fight

More than 300 sign up to investor action group

WILLIAM CAIN

GET INVOLVED: *This section is intended to uphold the interests of private investors. We would be keen to hear from you if there are company specific or market-wide issues you would like to see raised, debated and addressed. Please e-mail editorial@sharesmagazine.co.uk with your suggestions.*

A handful of the investors signed up to a ShareSoc action group on suspended AIM stock **Globo (GBO:AIM)** hold stakes previously valued in the hundreds of thousands of pounds, according to the shareholder association.

Around 300 people have signed up to the group so far via the ShareSoc.org website and the numbers are increasing rapidly says deputy chairman Roger Lawson.

Investors are being encouraged to sign up to the group, which is in touch with the company's administrators, so they can receive regular updates and receive any value which may be salvaged from the business.

Lawson compares the scandal to that of previous AIM-quoted retailer Torex and, going back further, the 1990s collapse of textile firm Polly Peck.

'Most of the investors I have spoken to so far have been fairly phlegmatic,' says Lawson. 'They are moderately experienced investors. It's not the same as when banks like Bradford & Bingley got into difficulties, where there were lots of unsophisticated investors that owned shares.

'They were often people that had absolute trust in the banks' directors and the company itself. They were investing their life savings in them and relying on the income.

'This seems a lot different but I am sure it will have had a serious impact on some people.

'Some investors had hundreds of thousands of pounds worth of shares but they seem to be more realistic about the possibilities going forward.'

Globo's last reported balance sheet, at 30 June 2015, showed cash net of total liabilities of €18 million (£13 million). But the outlook for salvaging shareholder money is not great after Globo went into administration on 3 November, admits ShareSoc deputy chairman Roger Lawson.

The administration process can take years and any legal action potentially launched by shareholders could only take place after other legal issues are resolved.

' We do not want to raise the hopes of investors too much,' says Lawson. 'On the other hand it's worth pursuing the legal action if not to recover the money then at least to get some justice in what is a terrible situation.'

Lawson says Globo's failure has exposed issues in **London Stock Exchange's (LSE)** regulation of the AIM market. In particular he questions the system where nominated advisers, known as nomads, are paid by companies but are also expected to regulate the same firm's behaviour.

'The main thing that concerns investors is how they got fooled by the people at Globo and why the auditors did not pick up on these issues,' Lawson says.

'There are a lot of complaints about auditors, NOMADs, non executive directors and the general regulation of AIM by the London Stock Exchange.'

Signing up to the site will allow investors to keep up-to-date with developments, Lawson adds.

'The point about building a contact list is we can email shareholders,' Lawson says. 'We've sent out two emails so far and we will communicate developments as and when they happen.'

Globo will delist on 1 December. The joint administrators said on 10 November that they do not anticipate there will be any return from the administration for shareholders of Globo.

Tom Walker
Portfolio Manager

Martin Currie Global Portfolio Trust (MNP)

Share price: 178p (as at 5 Nov)

NAV per share: 179.56p (as at 5 Nov)

Discount: 0.9%

FUND FACTS
(as at 30 Sep '15)

Type: Investment trust

Launched: 1999

No. of holdings: 60

Active share: 87.1%

Benchmark: FTSE World Index

Go global for growth

Martin Currie trust has proven pedigree with high-quality picks

JAMES CRUX

International equity markets remain volatile, still bowed following nervousness inspired by China's slowdown and the timing of a US interest rate rise.

The good news is these bouts of indiscriminate selling have thrown up opportunities for stockpicking funds. Investors of a nervous disposition can draw succour from a genuinely global equity fund which diversifies risk and has a strong long-term performance track record.

One such vehicle is the **Martin Currie Global Portfolio Trust (MNP)**, tasked with delivering long-term growth, in excess of the capital return of the FTSE World Index, by investing in a diversified portfolio of internationally-quoted companies. The trust is managed by charismatic Scotsman Tom Walker, a chartered accountant who boasts almost 30 years' investment experience, having previously run money at Baring Asset Management and Edinburgh Fund Managers.

Walker's charge not only benefits from being a genuinely global equity fund – it can select around 60 of the best companies from around the world – which spreads risk, but its prospects are also boosted by a deeply resourced team at Martin Currie, from which the seasoned stockpicker can draw support and inspiration.

With £180.7 million in total net assets at last count, the trust has delivered strong long-term outperformance of its FTSE World Index benchmark. Paying quarterly dividends since May 2013, Martin Currie Global Portfolio Trust has grown the payout by a compound annual growth rate (CAGR) of 7.4% since launch and it has never been cut.

The trust is ungeared and a zero discount policy was introduced in July 2013; this allows any shareholder to sell shares at or very close to net asset value (NAV), ensuring the share price doesn't languish at an unwarranted discount to the underlying assets.

'In volatile markets, making short term predictions is a mug's game,' says Walker. 'Martin Currie Global Portfolio Trust invests in a combination of companies that offer long term returns either because they are growing well despite the tough environment or because their valuation suggests most investors are too pessimistic about their long term potential. I am not assuming the world economy is about to take off – I don't think it will – but I'm focusing on stocks that can outperform in a slow growth, low interest rate environment.'

TOP TEN HOLDINGS (AS AT 30 SEP)

	Company	%
1	JP Morgan Chase (JPM:NYSE)	3.9%
2	Lockheed Martin (LMT:NYSE)	3.4%
3	L Brands (LB:NYSE)	3.4%
4	Prudential (PRU)	3.4%
5	Apple (AAPL:NDQ)	3.3%
6	Verizon Communications (VZ:NYSE)	2.7%
7	American International Group (AIG:NYSE)	2.5%
8	KDDI (9433:TSE)	2.3%
9	BG Group (BG.)	2.3%
10	Safran (SAF:PA)	2.3%

Source: Martin Currie

FOCUS ON FUNDAMENTALS

Walker's investment philosophy posits that it is possible to identify undervalued companies with strong or improving fundamentals, led by a valuation that is cheaper than the market, a proven growth track record and superior financial quality. He argues stock-focused portfolios, driven by fundamental research, are the best way to exploit the inefficiencies of Mr. Market and generate consistent outperformance.

Key characteristics of the fund include its focus on around 60 best ideas, as well as 'a three-to-five year time horizon that can see through short-term market noise'. Walker explains the fund is concentrated and high conviction and 'truly active', anything but a closet tracker. Its active share – a measure of the percentage difference between the portfolio holdings and the index constituents – is very high at 87.1%. 'The best way to outperform the index is to distance yourself from the index,' he explains.

OPPORTUNITY KNOCKS

Recent sell-offs have thrown up opportunities at stock level, insist Walker, an investor in the likes of tobacco giant **Philip Morris International (PM:NYSE)** and beer brewer **AB InBev (BUD:NYSE)**, in the midst of a mega-merger with **SABMiller (SAB)**.

Among his more recent purchases is **ARM Holdings (ARM)**, the leading microprocessors designer, bought on weakness inspired by the slowdown in China, a huge end-market for smartphones containing its chips. Walker points out ARM is a high-quality concern with unique intellectual property and the 'standard'

for scalable, energy efficient processors. The £15 billion cap's expensive rating, he argues, is justified by its strong earnings, cash flow and return on invested capital.

Walker has also bought **UPS (UPS:NYSE)**, the logistics and parcel delivery company he considered oversold. UPS, a beneficiary of recent investment in automation, is 'very high quality' and has 'very strong cash flows'.

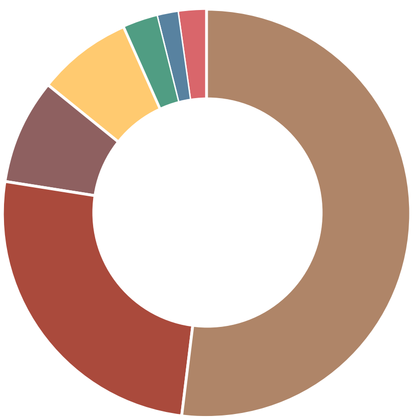
Another interesting addition to the portfolio is **Facebook (FB:NDQ)**, the Mark Zuckerberg-bossed social networking behemoth. 'Facebook, which includes Instagram and WhatsApp, is the leading play on growth in mobile display advertising,' insists Walker. 'Clearly, the advertising market is undergoing structural change with the growth of social media and Facebook has the data and user base to best allow advertisers to maximise their target audience.

'The company has a number of initiatives to increase engagement in and monetisation of its established and newer assets. I believe the strong top-line growth will lead to higher margins and positive earnings surprises. As such, it can easily grow into its apparently expensive prospective price-to-earnings ratio of thirty times.'

UPSIDE STATESIDE

A major opportunity for fund managers is the US consumer, though the retail market across the pond is proving tough for **Wal-Mart Stores (WMT:NYSE)** and others. Two strongly-performing US retailers owned by the trust are **L Brands (LB:NYSE)**, the specialty retailer behind intimate apparel chain Victoria's Secret, and **TJX (TJX:NYSE)**, the discount clothing, footwear and furniture retailer that trades as T.K. Maxx in Europe.

Both are growing strongly, drawing strength from their sale of differentiated product, keen pricing and strong supply chain management. Demonstrating the degree to which the trust can go global for growth is the presence of another retailer in the book, namely **Matahari Department Store (LPPF:JK)**, 'a very high growth company and the biggest department store group in Indonesia, where modern retail is still in its infancy'.

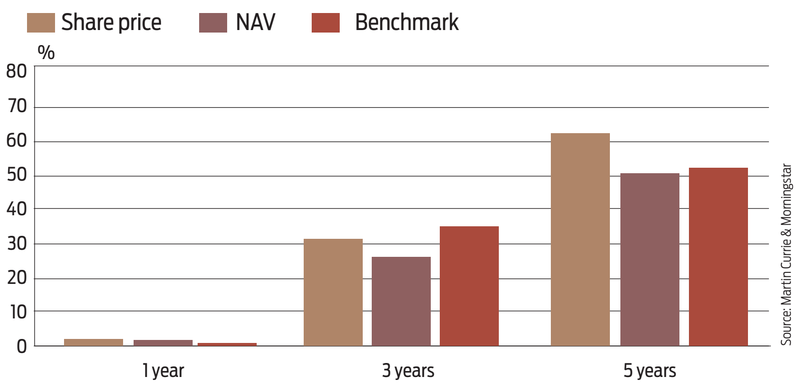


SECTOR BREAKDOWN
(as at 30 Sep)

North America	52.2%
Europe	25.5%
Japan	8.3%
Asia Pacific ex Japan	7.5%
Emerging markets	2.7%
Israel	1.7%
Cash	2.1%

Source: Martin Currie

CUMULATIVE PERFORMANCE (%)



A healthy property market

Government policy and rising longevity strengthen the investment case

MARK DUNNE

The real estate industry offers significant diversity. Investors looking to add bricks and mortar to their portfolio can buy residential, retail, office, industrial, self-storage and even student accommodation companies. But none of those sub-sectors have a more secure revenue stream or substantial growth drivers than the landlords who lease their properties to healthcare providers.

The expansion and modernisation of GP practices and clinics, collectively known as primary care, are central to the Government's healthcare provision policy. Plans to push more patients through the doors of local medical practices to reduce pressure on accident and emergency departments and hospital wards is good news for those owning such properties. The ultimate client is the Government and therefore the risk of rent defaults is extremely limited.

The other trend strengthening the case for investing in healthcare property is that people are living longer, which is expected to see demand for care home places rise.

There are only four listed property companies directly benefiting from these trends that investors can add to their portfolios.

Their attractions do not come cheap, all four trade at premiums to their net asset values (NAV), but the industry's growth drivers and high dividend yields make **Assura (AGR)** and **Target Healthcare REIT (THRL)** attractive investments. *Shares* also likes **Primary Health Properties (PHP)** as a business but notes the risk attached to a thinly-covered dividend.

THE TREND IS YOUR FRIEND

GP surgeries and clinics are central to prime minister David Cameron's plans to meet growing demand for the NHS' services while achieving his pledge to provide round the clock access to healthcare. Meeting rising demand is one of the biggest issues facing the health service.

People in England and Wales are living longer with 26% of the population expected to be at least 65 years old by 2065, up from 18% today, according to the Office of Budget Responsibility.

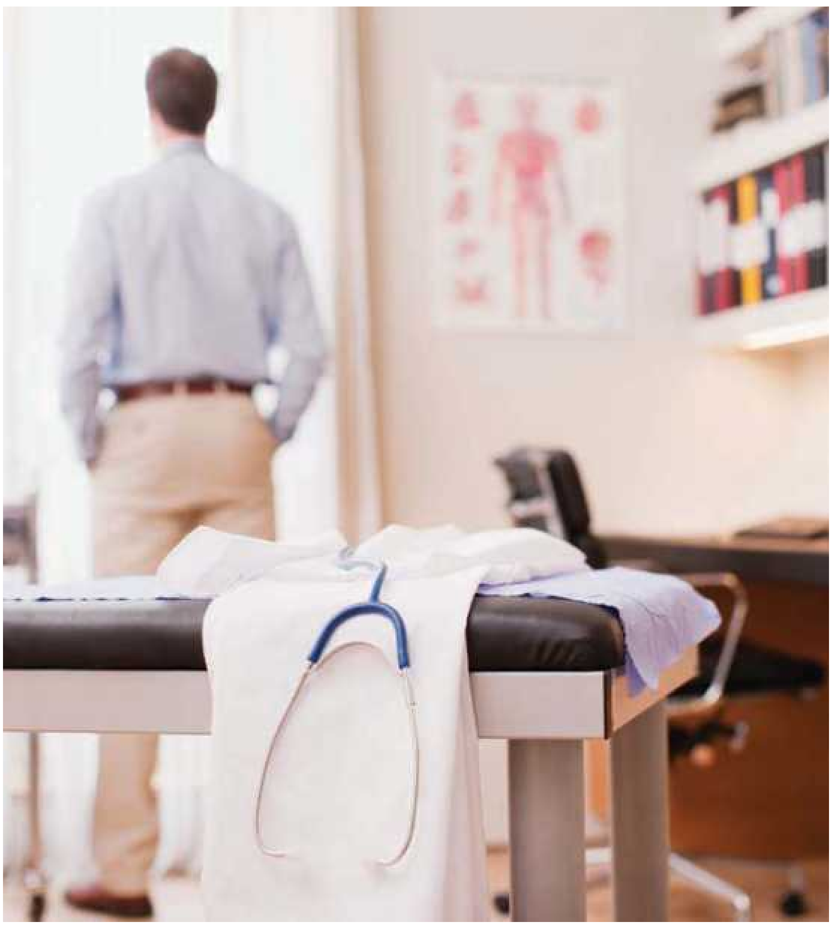
These demographics will not only put more demand on the NHS, but also on care homes as people become so elderly that they cannot live independently.

It's not just an ageing population that will heap pressure on various strands of the healthcare industry. The UK is projected to have 4.4 million more citizens in the next 10 years. Demand for the NHS' services will increase by 4% a year, according to financial services group Sanlam. That need is likely to be even greater in London. NHS analyst Roy Lilley puts the rate of increase at 7% in the capital.

To help meet this forecast build in demand the Government set out its vision of the UK's healthcare service in October 2014's NHS Five Year Forward View. The report highlighted several radical options to make healthcare provision more efficient, including the introduction of Accountable Care

HEALTHCARE PROPERTIES

SUMMARY
The growth drivers for companies developing, upgrading and managing properties for healthcare use are strong. The Government is the main client for these businesses, meaning that revenue security is high, while political will is creating demand. The industry could also be a play on the ageing population as more people become too elderly to live independently.



Organisations, single bodies responsible for a local population's health service.

Of interest to investors is the section of the review which describes the various models of care that will be used to provide services to suit local needs, such as treating more patients in the community by allowing GP surgeries to provide a greater range of care through employing consultants and senior nurses, while carrying out minor operations.

In 2014 the Government created the £1 billion Primary Growth Fund to finance the upgrading of NHS premises and infrastructure. Some £200 million has already been cleared for spending on around 1,000 GP practices. This, and the remaining £800 million still in the pot, will lead to increased development activity. The money is needed with half of primary care premises being more than 30 years old, mostly residential conversions, according to Primary Healthcare Properties, which, as its name suggests, is investing in modern purpose-built primary healthcare properties.

MEETING DEMAND

The real estate investment trust (REIT) has built a strong proposition in the market with a portfolio worth £1.1 billion spread across 272 assets, which are 99.6% occupied on leases averaging more than 15 years. It has an acquisition pipeline that management describe as 'strong' while its development is not speculative, being commissioned by the NHS.

The £483.1 million cap targets rent and valuation increases through upgrading its properties to improve the quality and range of services they can provide.

High occupancy, long leases and majority of rent paid by the Government, what's not to like? Well, there are a few points for investors to consider. One is that the shares are expensive, trading on a 27.9% premium with a 339p NAV. Bringing new developments on to the market and development gains should see this narrow. Another issue is the £679.6 million net debt it is carrying, which puts it on a 63.2% loan-to-value.

Then there is the 20p a share dividend it will pay for 2015, according to consensus, which at its 433.8p price is a 4.6% yield. The problem is that this is only 89% covered by forecast earnings, implying that debt or previously generated cash will have to foot the bill.

The sector's growth drivers and Primary Health Properties development pipeline make this an attractive stock, but only if it can get the dividend cover to more than one times covered.

Assura is another example of the company that is expanding its portfolio to meet demand. The £579.5 million cap has £96 million worth of acquisitions in its sights and £27 million of development projects. These are being funded by a £309 million share placing carried out in October.

The REIT's portfolio was worth £931 million as at 31 March generating £58.9 million in rent. Analysts at Liberum expect a 2.1p per share dividend in the year to 31 March 2016, putting the stock on a 3.6% yield.

The fourth listed primary healthcare investor is **Medicx Fund (MXF)**, which owns 147 properties in the UK and Ireland, 141 of which are fully let with six under construction. The portfolio generates £35.5 million in rent.

The fund's properties were collectively valued at £556 million by 30 June, which due to the acquisition of four healthcare centres for an initial £11.4 million last month (23 Oct) means that its 70.1p a share NAV is outdated and that the 21.5% premium has already started narrowing.

In theory this is an attractive income stock – at 85.2p the £310.4 million cap yields 7% based on a 6p payout – but like Primary Healthcare Properties its forecast dividend payment is not fully covered by earnings.

GROWTH INDUSTRY

Care home landlord Target Healthcare REIT's 28 properties are worth £146 million and the average lease is 29 years. There is more to come as the £158.3 million cap works on expanding its portfolio of purpose-built homes with £19 million worth of deals expected to close by the end of 2015. A further £14 million worth of deals are expected to complete early in 2016.

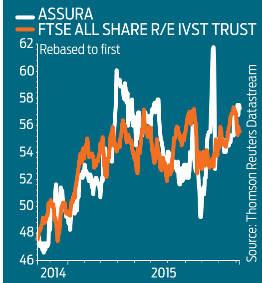
If these transactions go through then the current 99.2p a share NAV looks set to increase, closing a 12.1% premium to NAV. So with new assets expected to move into the portfolio and demand for places in its homes expected to rise investors should not be deterred from buying the share particularly given a well-covered prospective dividend yield of 5.5%. »

Assura
(AGR) 57.3p

Market value:
£579.5 million

Prospective PE Mar 2016:
22

Prospective PE Mar 2016:
21.2

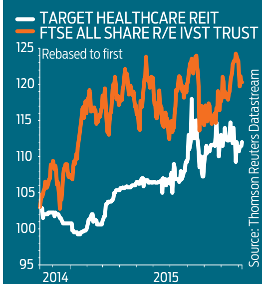


Target Healthcare REIT
(THRL) 111.3p

Market value:
£158.3 million

Prospective PE June 2016:
17.9

Prospective PE June 2017:
15.8

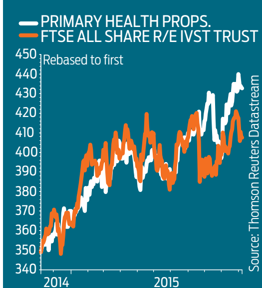


Primary Health Properties
(PHP) 433.8p

Market value:
£483.1 million

Prospective PE Dec 2015:
22.9

Prospective PE Dec 2016:
22.3



HEALTHCARE PROPERTY

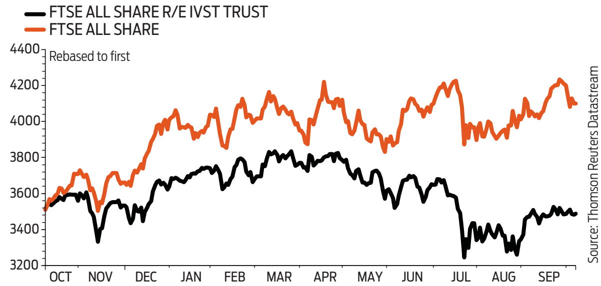
Three of the four companies in this sub-sector are listed under the Real Estate Investment Trust banner on the London Stock Exchange, so that is the sector focus for our 'dashboard'.

CORE HOLDING

Target Healthcare REIT

The REIT buys modern, purpose-built care homes for the elderly, which it leases on average for 29 years. Its 28 properties are collectively worth £146 million and it has some £30 million of deals in the pipeline, many of which should close before the end of 2015. Target is meeting growing demand for care home places. This is a market expected to rise with population growth headlines pointing to the number of people of pensionable age being more than a quarter of the population in the next 50 years.

SECTOR PERFORMANCE



BEST PERFORMING SECTORS, 2015

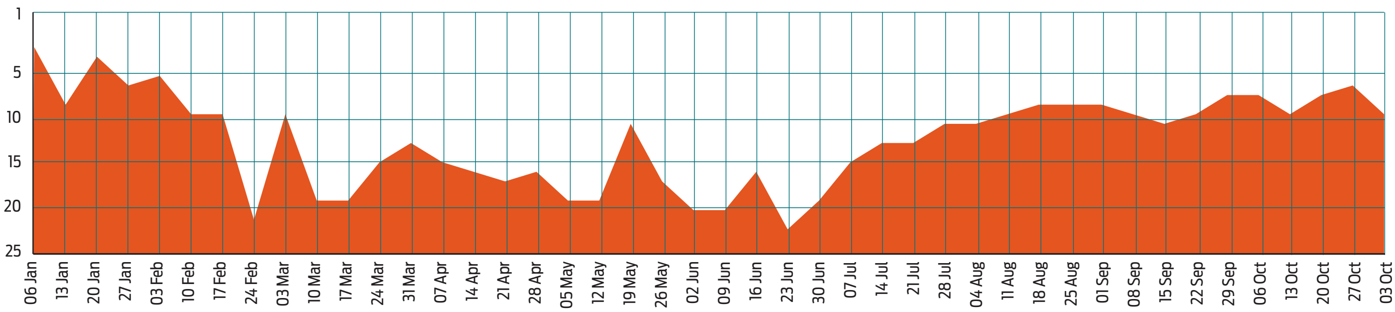
	Performance (%)
1. Forestry & Paper	42.9
2. Software & Computer Services	25.9
3. Household Goods & Home Construction	24.9
4. Nonlife Insurance	23.8
5. Real Estate Investment & Services	18.1
9. Real Estate Investment Trusts	13.3

WORST PERFORMING SECTORS, 2015

	Performance (%)
35. Oil & Gas Producers	-13.5
36. Automobiles & Parts	-17.0
37. Industrial Engineering	-18.4
38. Mining	-33.1
39. Industrial Metals & Mining	-46.7
FTSE ALL-SHARE	-1.0

Data to 03/11/2015. Source: *Shares*, Thomson Reuters Datastream

WEEKLY SECTOR RANKING, 2015



Source: *Shares*, Thomson Reuters Datastream

BEST AND WORST SECTOR PERFORMERS

ONE MONTH

Company	EPIC	Performance (%)
TOP		
Safestore	SAFE	11.4
Primary Health Properties	PHP	9.3
Capital & Regional	CAL	5.7
Mucklow (A & J)	MKLW	5.4
McKay Securities	MCKS	4.8
BOTTOM		
Custodian Reit	CREI	0.9
Shaftesbury	SHB	0.7
Standard Life Investments Property Inc Trust	SLI	0.6
Hammerson	HMSO	-0.3
Hansteen	HSTN	-0.8

THREE MONTHS

Company	EPIC	Performance (%)
TOP		
Capital & Regional	CAL	13.4
Tritax Big Box REIT	BBOX	8.4
Safestore	SAFE	8.2
Redefine International	RDI	7.9
Primary Health Properties	PHP	6.6
BOTTOM		
Shaftesbury	SHB	-1.2
Workspace	WKP	-2.2
Segro	SGRO	-2.2
Schroder Real Estate Investment Trust	SREI	-3.3
Hammerson	HMSO	-6.1

TWELVE MONTHS

Company	EPIC	Performance (%)
TOP		
Safestore	SAFE	51.2
Workspace	WKP	47.4
Capital & Regional	CAL	45.3
Big Yellow	BYG	37.5
Shaftesbury	SHB	30.9
BOTTOM		
Mucklow (A & J)	MKLW	4.5
Hammerson	HMSO	2.6
Intu Properties	INTU	1.6
Custodian Reit	CREI	1.4
Schroder Real Estate Investment Trust	SREI	-0.4

PEST ANALYSIS

POLITICAL	ECONOMIC	SOCIAL	TECHNOLOGICAL
· Healthcare policy	· Rising healthcare spend	· Ageing population	· Upgrading GP surgeries
· Round the clock services	· £1bn development fund	· Population growth	· Minor operations in clinics
· Expanding use of GP surgeries	· Government is the client	· Rising dementia cases	· Booking appointments online

SECTOR BROKER CALLS - LIVE RECOMMENDATIONS

Company	Broker	Start date	Action	Previous recommendation	New recommendation	Previous target (p)	New target (p)	Share price (p)	Target change (p)
Hammerson	HSBC	7/10/15	Upgrades	Hold	Buy	685.0	667.0	609.0	-18.0
Workspace	Numis	6/10/15	Upgrades	Hold	Add	-	-	942.5	-
Great Portland Estates	Numis	6/10/15	Upgrades	Hold	Add	-	-	855.5	-
Derwent London	Numis	6/10/15	Upgrades	Hold	Add	-	-	3,739.0	-
Shaftesbury	Exane BNP Paribas	27/8/15	Downgrades	Neutral	Underperform	910.0	910.0	911.0	0.0
Hammerson	Jefferies International	24/8/15	Downgrades	Hold	Underperform	622.0	584.0	609.0	-38.0
British Land Co	Jefferies International	24/8/15	Downgrades	Buy	Underperform	894.0	741.0	835.0	-153.0
Intu Properties	Jefferies International	24/8/15	Downgrades	Hold	Underperform	317.0	288.0	337.7	-29.0
Great Portland Estates	Barclays Capital	17/8/15	Initiates/Starts	-	Overweight	-	977.0	855.5	-
Great Portland Estates	Investec	3/8/15	Upgrades	Hold	Buy	912.0	912.0	855.5	0.0

Data to 04 November 2015
Source: Shares

SECTOR DIRECTOR DEALS OF THE PAST SIX MONTHS*

Company	Director	Position	Date	Price (p)	Amount	Value (£)
TOP BUYS						
Capital & Regional	Louis Norval	NED	23/09/15	66.0	1,999,940	1,320,280
CLS Holdings	Sten Mortstedt	CH	12/08/15	1,874.9	10,000	187,491
Capital & Regional	Hugh Scott-Barrett	CEO	02/10/15	66.2	167,946	111,180
Development Securities	Marcus Shepherd	FD	21/10/15	238.8	41,884	99,998
Capital & Regional	Hugh Scott-Barrett	CEO	13/08/15	66.0	117,055	77,256
TOP SELLS						
CLS Holdings	Sten Mortstedt	CH	28/09/15	2,190.00	140,533	3,077,673
Helical Bar	Michael Slade	CEO	10/09/15	421.00	492,000	2,071,320
Helical Bar	Gerald Kaye	ED	10/09/15	421.00	355,000	1,494,550
Helical Bar	Nigel Mcnair Scott	CH	10/09/15	421	100,000	421,000
Capital & Regional	Hugh Scott-Barrett	CEO	02/10/15	65.90	145,000	95,555

**Only trades worth £10,000 or more included*
Data to 04 November 2015
Source: Shares

Dollar soars over yen

Divergent monetary policies mean US currency strength against Japanese counterpart

DAVID JONES

As it pushes out to a two month high we take another look at the US dollar/Japanese yen currency pair which we last covered in September (*Forex, Shares*, 3 Sep).

It had been trading in a wide but fairly directionless range until a knock the lights out US non-farm payrolls number (6 Nov).

The Bank of Japan (BoJ), met at the end of October and there was plenty of speculation that it would try and boost the economy by adding to its quantitative easing (QE) programme.

In the end, the Bank decided to keep its powder dry but many traders still expect that Japan adding to its already significant stimulus is a matter of *when* and not *if*.

Exports are weak, inflation and consumer spending are both low and, after stagnating for decades, the consensus appears to be that the economy still needs a jolt to bring it fully back to life. The BoJ said it now expected growth to come in at 1.2% in the year to March 2016, down from its earlier 1.7% forecast.

The slowdown in demand in emerging markets in Asia has taken its toll on the Japanese economy in recent months - it shrank by 0.4% in the second quarter of the year and the Japanese stock market index, the Nikkei, is still a good 10% below its summer highs. With Japan at risk of slipping into recession, more intervention from the central bank would not be a surprise and, of course, traditionally more QE would devalue the yen and push USD/JPY higher.

The main obsession for traders watching the US dollar revolve around just when exactly its central bank, the Federal Reserve, is going to raise its interest rate.

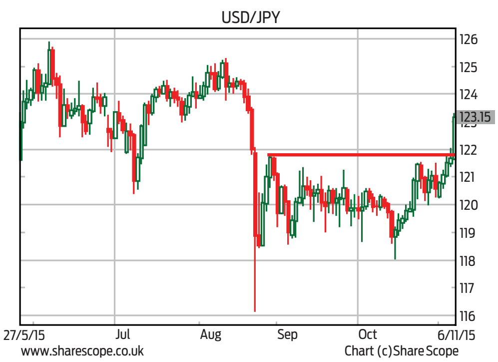
The US economic outlook is not without its own risks, such as the US dollar strength over the past 12 months making its exports more expensive. But it is not a stretch to say it is in far ruder health than Japan at the moment particularly after the bullish employment figures.

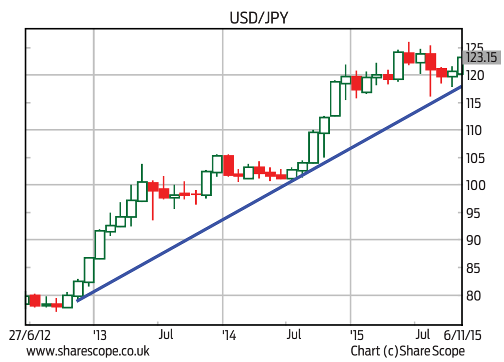
In total 271,000 jobs were added, against the 180,000 expected and as a result December is the month when US rates are finally expected to move off rock bottom (16 Dec).

You could be forgiven for becoming somewhat bored by this, as it has been a topic of discussion for the majority of 2015. And most forecasts have proved wrong, with the prediction for a rise getting pushed back on what was sometimes a month-by-month basis. Policy makers are sensitive to economic data in recent months so, if we saw some poor numbers coming out of the USA in the weeks ahead of this, the market could be forced to revise its expectations yet again.

Increasing interest rates should make the US dollar more attractive. This coupled with the prospect of further QE in Japan does suggest that the logical direction for USD/JPY is up. And it looks like the chart is starting to point that way with the pair making the first tentative steps out of its recent range.

The logical first target would be for a run back to the June highs just shy of 126. For shorter term traders thinking about buying into this breakout, there has been good recent support at the 120 level from late October. Looking to buy dips and setting stop losses the other side of this level would seem to make sense as an initial trade.





Big brands make waves

We analyse the trends for two household names

DAVID JONES

A COUPLE OF familiar household names are back in the news, although one of them probably wished it was not making the headlines again. **Marks & Spencer (MKS)** announced its latest quarterly results and **Volkswagen (VOW:ETR)** had to hold its hand up to even more engines being affected by the emissions scandal. Here's what the charts are saying.

Marks & Spencer (MKS)

Buy 530p

Target 650p

Stop Loss 470p

WHENEVER MARKS & SPENCER delivers results, the talk is often about when it is going to manage to turn around its flagging clothes business, with sales here habitually dropping quarter on quarter. But many shareholders will not be losing too much sleep simply over the fashion of the company's latest skirts as the share price has risen by around 25% over the past 12 months. The latest results have given the price fresh impetus and it does look to have shaken off the correction that has been in place since June.

Marks & Spencer has been in a solid uptrend since late 2008 and the mantra has been to buy weakness. Assuming the latest correction has been broken, the first logical target is for a move back to this year's highs at 600p. Assuming the longer term trend will persist then a more ambitious target of 650p, from the end of 2007, does not seem over optimistic.

Volkswagen (VOW:ETR)

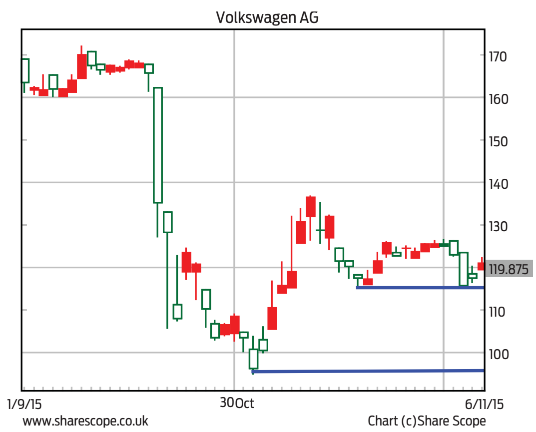
Buy €120

Target €170

Stop Loss €94

THE NEWS SURROUNDING the emissions rigging scandal seems to go from bad to worse for German-listed car giant Volkswagen. Last week the company said that more engines could be affected and for the first time suggested it would include some petrol variants. Since the initial findings, it dropped by 40% in less than a month.

It is often said that the time to buy is when others are panicking. There is a positive sign for the brave investor. The optimist could say that the bad news has now been factored into the price. The chart leaves a couple of obvious points for stop losses; extra important in an aggressive strategy like this where we are attempting to catch a falling knife. First of all, the €115 level has brought the buyers out in recent months so for those who want a tighter level of risk; a stop below this support would be suggested. The €95 October low is the ultimate stop loss. A break to new lows would suggest the downtrend is resuming and is time to abandon any medium term hopes for recovery.



BROKER RATING: SELL HOLD BUY NOT AVAILABLE

Bold move on Northbridge

Three directors swoop for 4.5% of the business

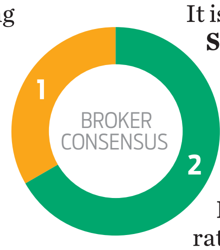
WILLIAM CAIN

Investors might be forgiven for giving up on specialist equipment rental outfit **Northbridge Industrial (NBI:AIM)** but its directors certainly haven't lost faith.

Chairman Peter Harris, chief executive Eric Hook and non-executive David Marshall bought a combined 850,000 shares of the business, around 4.5% of its issued share capital, at 70p on 3 November 2015.

Purchases by the directors saw Northbridge's stock price surge to 90p. But after a plunge this year the stock still trades at a sizeable discount to its 127p tangible book value (0.71 times), reported at interim results released on 30 September 2015.

As a result of this situation and the recent director buying we remain cautiously bullish on Northbridge after a terrible 2015.



It is worth noting UK tool hire market leader **Speedy Hire (SDY)** is now only a little more expensive than Northbridge on a price-to-book value basis (0.81 times).

Another comparative valuation for investors to consider is that the proposed takeover of sector peer **APR Energy (APR)** was made at a much lower ratio, around 0.4 times book value.

Our bullish call on Northbridge on 29 January 2015 at 450p a share is well in the red, down 79% following sector-related problems.

The three directors now own a total stake of 23% in the business.

SHARES SAYS:

Good news for shareholders though we'd expect a turnaround to take some time.

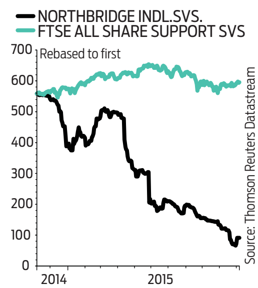
THE TRADE

Buyers:
Peter Harris (Ch) Eric Hook (CEO), David Marshall (NED)

Consideration:
£500,500

No. of shares bought:
850,000

Subsequent holding:
4.235 million (23%)
- all three directors' stakes combined



DEALS THIS WEEK

Company	Director	Pos.	Date	Price (p)	No. of shares	Value (£)
TOP BUYS						
Northbridge Industrial	**David Marshall**	**NED**	**02/11/15**	**70.0**	**600,000**	**420,000**
Jardine Lloyd Thompson	Dominic Burke	CEO	04/11/15	889.6	30,000	266,884
Gaming Realms	Michael Buckley	CH	03/11/15	25.0	1,000,000	250,000
Northbridge Industrial	**Eric Hook**	**CEO**	**02/11/15**	**70.0**	**150,000**	**105,000**
Fastjet	Tim Ingram	NED	06/11/15	60.0	150,000	90,000
Northbridge Industrial	**Peter Harris**	**CH**	**02/11/15**	**70.0**	**100,000**	**70,000**
HSBC	Sir Simon Robertson	NED	04/11/15	511.6	9,770	49,985
Equiniti	John Parker	NED	04/11/15	158.0	31,439	49,674
Ariana Resources	Michael de Villiers	CH	02/11/15	1.0	4,588,888	45,889
Haydale Graphene	Ray Gibbs	CEO	02/11/15	160.0	26,875	43,000
Techfinancials	Asaf Lahav	CEO	04/11/15	14.5	269,830	39,125
St Ives	Matthew Armitage	CEO	02/11/15	185.0	19,654	36,360
Meggitt	Guy Berruyer	NED	02/11/15	355.4	10,000	35,543
Techfinancials	Jeremy Lange	ED	04/11/15	14.5	220,260	31,938
St Ives	Brad Gray	FD	02/11/15	185.0	11,231	20,777
TOP SELLS						
4imprint	Andrew Scull	ED	05/11/15	1286.0	11,383	146,385
Boxhill Technologies	Lord Razzall	CH	02/11/15	0.3	14,000,000	44,800

Source: *Shares*

Key

CD	commercial director
CEO	chief executive officer
CED	chief executive of division
CFO	chief financial officer
CH	chairman
COO	chief operating officer
CS	company secretary
D	director
DCH	deputy chairman
ECH	executive ch
ED	executive director
FD	finance director
MKD	marketing director
NECH	non-executive chairman
NED	non-executive director
OD	operations director
SD	sales director
SEC	secretary

ENTERPRISING RETURNS

WE LOOK AT HOW EIS AND SEIS SCHEMES STACK UP FOR INVESTORS

CHERRY REYNARD

In theory, enterprise investment schemes (EIS) have a lot to recommend them: seductive tax advantages, exciting prospective returns, plus the warm and fuzzy feeling of directing capital to those small businesses that need it most. But is the reality as good for investors? Do their advantages extend beyond the – undoubtedly attractive – tax reliefs?

EIS Schemes were founded in 1993 as one of a range of government initiatives to encourage capital into small businesses. Since their launch almost 22,900 individual companies have received investment through the scheme and over £12.2 billion of funds have been raised.

The importance of these small businesses to the UK economy should not be underestimated. The Octopus High Growth Small Business Report 2015 (commissioned by Octopus Investments and produced by the Centre for Economics and Business Research) found that one in every three new jobs in the UK and almost 20% of economic growth was created by high growth small businesses. This was an average of 4,500 new jobs per week throughout 2014, three times more than created by FTSE 100 companies.

It is also clear that these small businesses have struggled to obtain funding in recent years as banks have exited higher risk lending. During the financial crisis, many small businesses found credit lines closed, which forced them to downsize or close altogether. Although small business lending has

picked up more recently, banks are still extremely cautious in their lending practices.

As such, schemes such as EIS and its little sibling the seed enterprise investment scheme (SEIS) have become an important funding source for companies. But does it make them good investments?

ROCK AND ROLL

EIS investments may be small, but they are not homogenous. As Rupert West, director at Puma Investments, says: 'EIS is not an asset class of itself, but an investment wrapper. It is a set of rules and if a company meets those rules, they qualify. However, there are many different styles and risk profiles. It could be venture technology that is super high-risk or it could be a chain of greengrocers. They will be completely different.'

Chris Allner, head of investment at Downing agrees: 'EIS covers the risk spectrum, from the rock 'n' roll element with no profits, to more stable businesses. At the riskier end, there will be a high chance it won't work, but when they do work they will produce very high returns. At the other end are those companies that may be struggling to get bank funding, but need money to help them grow. The companies will have sales, customers and tangible assets.'

Around 50% of the EIS market is in smaller, one-off EIS investments. This might be investing in a friend's business that happens to qualify for the various tax reliefs or individual crowdfunding opportunities. These will be ad hoc. The other half of the market is run by professional fund management groups.

These groups will, for a fee, deliver a curated set of EIS opportunities. Investors get the benefit of the manager's experience both in selecting those companies that look likely to work and in building those companies up into successful businesses.

> "EISs should be looked upon as a five-to-seven year investment at least."

Even within the fund management sector, there will be differences. Octopus, for example, offers two types of EIS: The Octopus Eureka EIS backs high risk early-stage companies – among its success stories has been property website **Zoopla (ZPLA)** – while its standard EIS focuses on the energy sector.

Downing Ventures, in contrast, tends to focus on lower risk businesses, particularly those in the leisure, hospitality and education industries. Puma Investments firmly classifies itself at the 'greengrocer' end. West says: 'We like asset-backed companies, companies with some operational real estate, where we can acquire the freehold and if it goes wrong, we have an asset that can be sold. This gives us downside protection.'

NOT FOR FAINT HEARTED

EISs have some advantages over their near-cousins the venture capital trust (VCT) because losses can be offset against income tax, but small businesses – even those that have been chosen for their resilient characteristics – tend to be more vulnerable than larger businesses and some EIS schemes have seen heavy losses. To qualify under the EIS rules, companies can have up to £15 million in gross assets and up to 250 employees. They may be established, but they still need careful nurturing.

EIS scheme managers protect themselves in two ways: The first is selecting the right company, the second is ensuring it doesn't fail once they have invested. Scheme managers will usually have a significant network from which they can select opportunities. Allner at Downing says: 'We are talking to lots of introducers around the country. This is a big source of deal flow. That said, transactions are often from people that we knew well. We only transact around 20 to 30 deals per year.'

They also have some key relationships. Allner adds: 'For example, we have an agreement with the Ministry of Defence. They develop a lot of new ideas as part of their research, originated for a military purpose. They share some of these ideas with us to see whether we can create businesses out of them. For example a recent one included technology for surveillance and we had to look for ways to commercialise it.'

From there, the managers are fully involved in the running of the company. West says: 'Our ethos is to back people and be personality-driven. We are looking to incentivise them and we want to see a big personal commitment. We want to see a big part of net personal wealth. EISs can't be controlled by another corporation. We maintain an extensive set of veto rights. We can say no to almost anything.'

BIG INFLUENCE

Management groups will often take a seat on the board and be consulted on the appointment of senior staff. They will retain the right to say no to business decisions that drift

from the original business plan. Octopus has a panel of 'captains of industry' that it can bring in to help companies grow. John Thorpe, business line manager for EIS at Octopus, says: 'We supported one group that delivered healthy lunchboxes to offices. One of our panel had been the leading almond exporter into the UK, so he was able to advise them on negotiating with suppliers and finding the right price. We are always hands-on and involved.'

Allner says: 'The whole area of funding is not only about the provision of funding but about expertise. We have spent around 30 years supporting small businesses and have a lot of expertise for those starting fresh. We can help companies as they evolve, we can go through the pressures and stress points. We can help these businesses grow in less painful ways.'

EIS schemes are different from crowdfunding, though in practice, some crowdfunding schemes may qualify for EIS reliefs and groups such as Crowdcube have their own EIS funds. Allner says that while the two can happily co-exist, crowdfunding will often attract different types of business.

He adds: 'A crowd-sourced pool of capital could meet the EIS rules. Most of the businesses we talk to, it is not their first time for funding. For crowdfunding businesses, they will often be consumer-facing brands. They will tend to be a bit early-stage for us. We tend to invest with seasoned entrepreneurs. Also, we believe the experience we provide is valuable.'

Nevertheless, it is worth establishing whether a crowdfunding scheme qualifies for EIS relief as this can make the investment far more attractive.

DATA ISSUE

One thorny area for EIS investment is the issue of performance. It is extremely difficult to get comparative performance data for EIS schemes. This differentiates them from VCTs, where performance data is readily available on sites such as Financial Express and Morningstar.

With EIS investment, investors are simply handing a pool of capital to a business for them to invest. At that point, there is no immediate exit strategy. It is against the EIS rules for there to be an exit strategy. Exit strategies come in a variety of different guises: there may be a trade sale or an IPO. Equally, new investors may come in, such as private equity, to replace the EIS investors. The latter may get some share of the profits. Or they may not. This is extremely difficult to predict.

Thorpe says: 'Investors need to wait a minimum of three years to qualify for the tax reliefs. However, we would suggest that EISs should be looked upon as a five-to-seven year investment at least. It may not be the right time for the company and there might not be a buyer for the shares.' He points out that returns can be lumpy.

For investors selecting a good EIS provider, much must be done on trust and historic track record. How have the group's previous EIS portfolios performed? What is their style? Are they looking for greengrocers or the next technology superstar? Are they investing in areas that have attractive tax breaks that may disappear, such as the energy industry? For those selecting individual opportunities, the process is even trickier. Investors must become due diligence experts in their own right, gathering all the information possible on a company and making a judgement.

CASE STUDY: QUENCHING YOUR THIRST

TWIZOO IS A mobile app that gives users live information about restaurants and bars, based on **Twitter** (**TWTR:NYSE**) sentiment analysis. The company developed intellectual property that analyses all of the tweets about a specific subject – currently 'London restaurants' – and displays the aggregated sentiment as a heat map to assist users in deciding where to eat or drink.

Twizoo was built to take advantage of this changing dynamic in how we make decisions, initially in the bar and restaurant market in London after a lack of trust in review services such as TripAdvisor. Some users believe these products can be gamed, and are often providing out-of-date information.

The company does this by buying tweets from the Twitter 'Firehose' and then using a series of algorithms to analyse those tweets for sentiment analysis. Since its launch September 2014, Twizoo's big data machine has analysed over one million Tweets. The app has been downloaded over 20,000 times and has Monthly Active User base of c. 10,000 Londoners.

(source: Downing Ventures)

TAX RELIEF:

ENTERPRISE INVESTMENT SCHEMES

1 **Income tax** – tax relief of 30% is available for investments up to £1 million in any one year. The shares must be held for at least three years or the tax relief will be withdrawn.

2 **Capital Gains Tax** – all gains made in an EIS scheme are free from capital gains tax if they are held for at least three years. Equally, payment of an existing capital gain can be deferred when the gain is invested in shares of an EIS-qualifying company. The investment must be made one year before or three years after the gain was made.

3 **Loss relief** – if shares in an EIS are sold at a loss, the investor can set their loss against their income tax bill for that year or the previous year.

4 There is no inheritance tax to pay on EIS scheme shares.

QUALIFYING COMPANIES

To qualify for EIS relief a company cannot have gross assets exceeding £15 million. It cannot have more than 250 employees and must be carrying out a qualifying trade (this means that it is commercial company, designed to make profits).

SEED ENTERPRISE INVESTMENT SCHEMES

1 **Income tax** – Investors can receive initial income tax relief of 50% on investments up to £100,000 per tax year.

2 **Capital gains tax** – Investors receive a full capital gains tax exemption if profits are reinvested in a SEIS in the same year. There is no capital gains tax on any profits made in a SEIS scheme.

3 **Loss relief** – if shares in an EIS are sold at a loss, investors can set their loss against their income tax bill for that year or the previous year.

4 There is no inheritance tax to pay on SEIS scheme shares.

QUALIFYING COMPANIES

The company must have fewer than 25 employees and gross assets of less than £200,000.

COMMERCIAL SENSE

What happens if businesses don't work? Allner cautions against simply backing a brilliant idea: 'It has never been easier to start a business. There are lots of bright people, but they have to be commercially aware to build a good business. If they cannot execute their brilliant idea, it is not worth investing. They need to be commercial, with sales skills. Ultimately, we want to invest in businesses that can become big businesses.'

If a business isn't working, the fund managers will work closely with management to assess why and whether the problems can be fixed. In many cases investors will simply have to resign themselves to losing money, though they may get some money back if the company has assets to sell. These losses can be offset against income tax and investors will keep their other tax reliefs, but this may be scant consolation for those who have invested heavily. In practice, if an investor has spread their risk across several different schemes, the losses may not be as painful.

SEIS schemes have added tax relief available for investors over and above those available from EIS schemes, but the companies in which they can invest are smaller and therefore higher risk than those available within EIS schemes. SEISs are generally not offered by the fund management groups. The investment limits are smaller and most consider that while it is worthwhile doing lots of due diligence to make an investment of £200 million, it is uneconomical to do so on an investment of £5 million.

ADDITIONAL RISKS

To some extent, this introduces additional risks for the SEIS structure – it means that investors generally don't have access to a 'curated' option, leaving them to do the due diligence themselves. Nevertheless, sites such as SEIS Window – www.seiswindow.org.uk/ – list the main options for investors in sourcing SEIS opportunities. In practice, many crowdfunding options may also qualify for the SEIS scheme, though investors need to check. Usually companies will make clear they have SEIS 'advanced assurance' – a certificate from the taxman, HMRC confirming that investors will benefit from SEIS.

EISs have generally been seen as a product for sophisticated investors and, in reality, the tax benefits only really make sense if an investor has large tax bills to mitigate. Thorpe says that their clients tend to use them when they have filled out their other tax free options. He adds: 'Often, if an investor has a well-funded company pension scheme – as might be the case for a doctor – they will find themselves bumping up against the lifetime allowance quite quickly. EISs and VCTs can be an alternative area.'

IHT APPEAL

It can also be useful for inheritance tax planning. Thorpe says clients may have exited a business, but still hold large amounts of shares. If they sell, they may pay a significant capital gains tax bill, but if they leave them, their heirs will pay a significant inheritance tax bill. Rolling the shares over into an EIS scheme progressively can defer the gain and mitigate inheritance tax.

Ultimately, it is impossible to divorce the investment case for EIS and SEIS from their tax advantages. Most investors probably wouldn't take the risk in these smaller companies were it not for the tax advantages, but you should never make an investment decision purely based on tax advantages. The lack of performance data and difficulty of assessing the different options should encourage caution. For those feeling brave, the Enterprise Investment Association is a good place to start.

FTSE 350

· TOP 10 ·

1 MONTH ▲

COMPANY	EPIC	PERFORMANCE (%)
Allied Minds	ALM	33.4
Cable & Wireless Communications	CWC	26.0
Electrocomponents	ECM	22.7
SuperGroup	SGP	19.8
Al Noor Hospitals	ANH	17.5
Domino's Pizza UK & IRL	DOM	17.2
Ocado	OCDO	16.2
Brown (N)	BWNG	15.9
InterContinental Hotels	IHG	15.1
Hargreaves Lansdown	HL.	13.8

3 MONTHS ▲

COMPANY	EPIC	PERFORMANCE (%)
Polymetal International	POLY	31.0
OneSavings Bank	OSB	28.8
Amlin	AML	26.2
Al Noor Hospitals	ANH	23.7
AO World	AO.	22.5
Hargreaves Lansdown	HL.	22.2
Regus	RGU	20.1
IP	IPO	18.8
Coca-Cola HBC	CCH	18.1
Domino's Pizza UK & IRL	DOM	18.1

12 MONTHS ▲

COMPANY	EPIC	PERFORMANCE (%)
JD Sports Fashion	JD.	110.4
SuperGroup	SGP	104.4
OneSavings Bank	OSB	90.9
Greggs	GRG	90.0
Allied Minds	ALM	86.4
Rightmove	RMV	81.5
Regus	RGU	77.1
Rank	RNK	71.3
Ted Baker	TED	70.2
Provident Financial	PFG	69.5

· BOTTOM 10 ·

1 MONTH ▼

COMPANY	EPIC	PERFORMANCE (%)
Foxtons	FOXT	-19.7
Meggitt	MGGT	-22.0
Hunting	HTG	-22.1
Acacia Mining	ACA	-22.2
Home Retail	HOME	-23.5
Petra Diamonds	PDL	-23.7
SIG	SHI	-28.0
TalkTalk Telecom	TALK	-28.2
Pearson	PSON	-31.0
Amec Foster Wheeler	AMFW	-34.5

3 MONTHS ▼

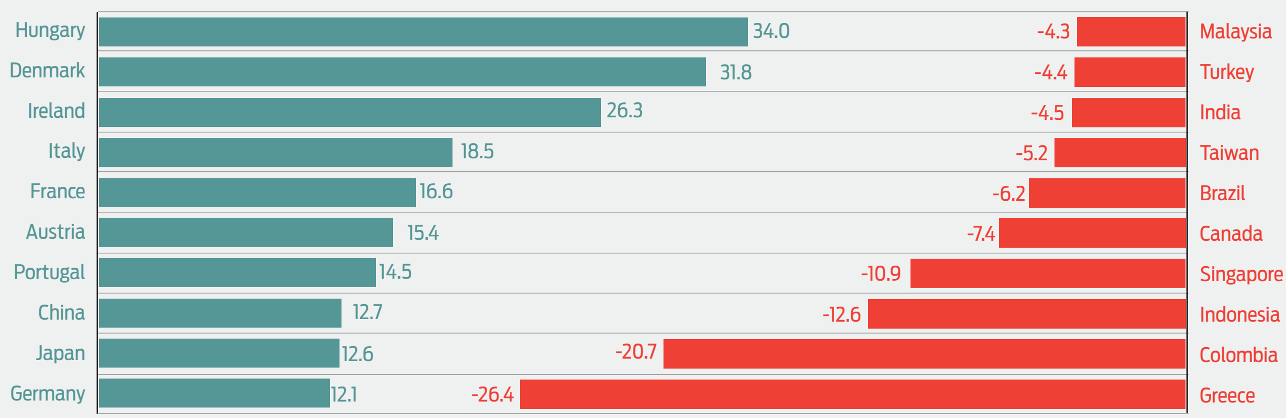
COMPANY	EPIC	PERFORMANCE (%)
Pearson	PSON	-30.8
Anglo American	AAL	-32.2
Home Retail	HOME	-34.4
Standard Chartered	STAN	-34.5
Amec Foster Wheeler	AMFW	-35.2
KAZ Minerals	KAZ	-36.0
SIG	SHI	-36.8
Premier Oil	PMO	-37.5
Glencore	GLEN	-41.9
Petra Diamonds	PDL	-52.6

12 MONTHS ▼

COMPANY	EPIC	PERFORMANCE (%)
Amec Foster Wheeler	AMFW	-50.8
Hunting	HTG	-51.4
Drax	DRX	-53.7
Petra Diamonds	PDL	-56.9
Tullow Oil	TLW	-57.0
KAZ Minerals	KAZ	-58.2
Anglo American	AAL	-60.5
Serco	SRP	-61.6
Glencore	GLEN	-63.5
Premier Oil	PMO	-70.1

* Excluding Equity Investment Instruments, Nonequity Investment Instruments
Date to:09/11/2015. Source: Thomson Reuters Datastream

GLOBAL MARKETS (%)



Covers period 01 Jan to 09 Nov 2015. Local currency terms. Source: *Shares*, Thomson Reuters Datastream.

THE BEST & WORST PERFORMERS
DATABANK

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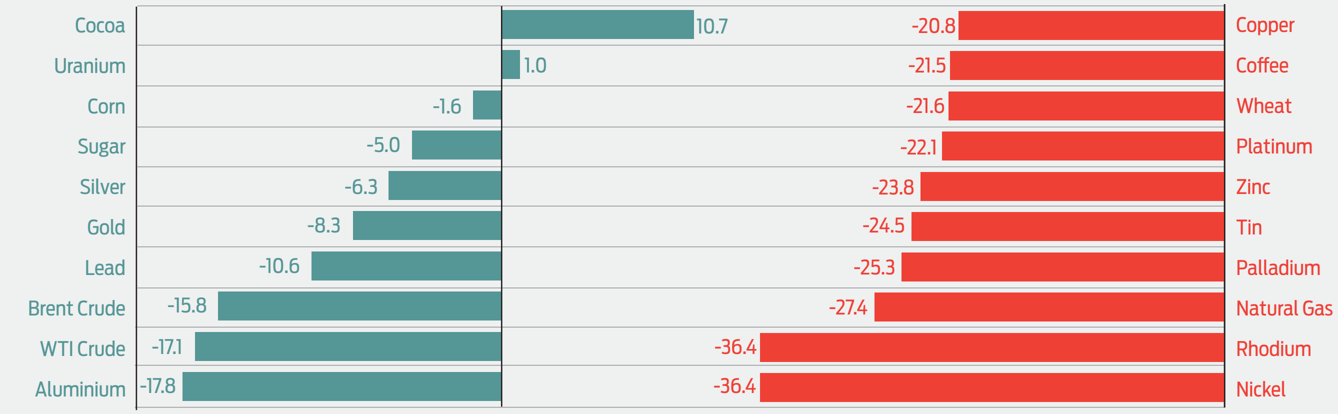
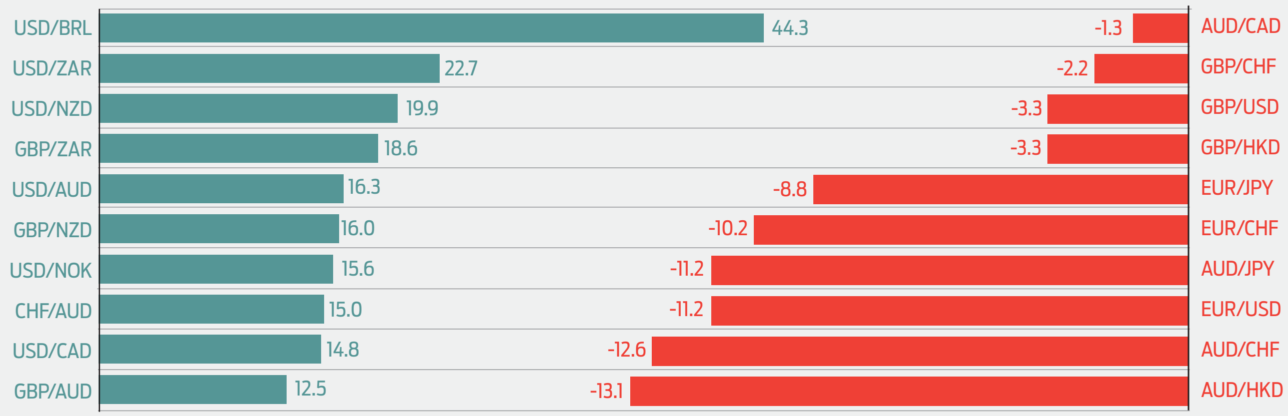


Covers period 01 Jan to 09 Nov 2015. Source: *Shares*, Thomson Reuters Datastream.

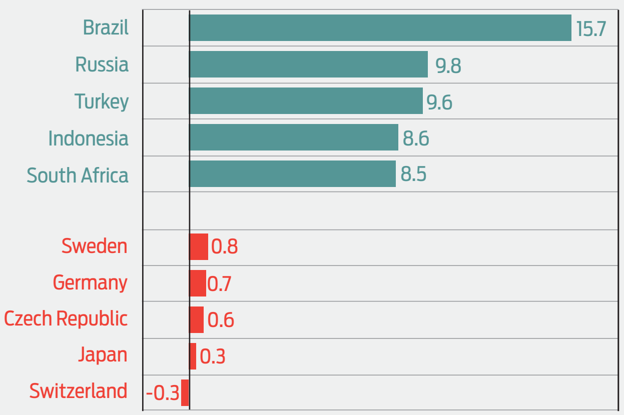
FOREX (%)



Covers period 01 Jan to 09 Nov 2015. Source: *Shares*, Thomson Reuters Datastream.

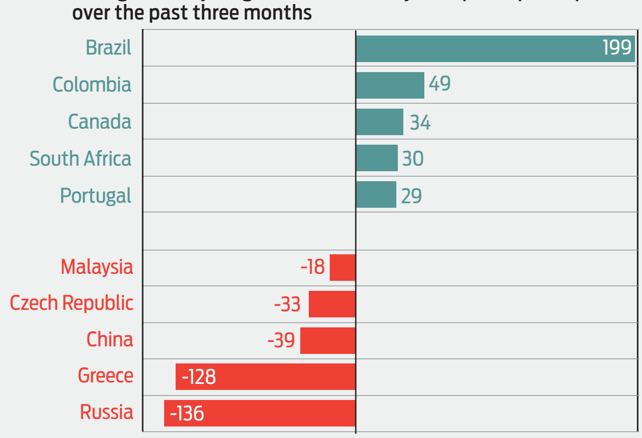
SOVEREIGN YIELDS (%)

Ten-year government bond yields (%)



Data as of 09 Nov 2015. Source: *Shares*, Thomson Reuters Datastream.

Change in ten-year government bond yields (basis points) over the past three months



Data to: 09 Nov 2015. Source: *Shares*, Thomson Reuters Datastream.

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